

The Electric Utility Industry Restructuring Transition Advisory Committee

A Report to the Governor and the 56th Legislature

December 1998

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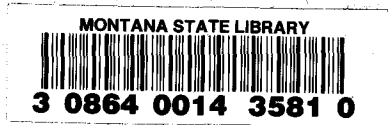
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The Electric Utility Industry Restructuring

TRANSITION ADVISORY COMMITTEE

Chair: Senator Fred Thomas

Vice-chair: Representative Bill Ryan

COMMITTEE STAFF:

**Stephen Maly, Research Analyst
Todd Everts, Legislative Environmental Analyst
Judy Keintz, Secretary**

PUBLISHED BY:

**Montana Legislative Council
Representative Larry Hal Grinde, Presiding Officer**

**Montana Legislative Services Division
Robert B. Person, Executive Director
David D. Bohyer, Director, Office of Research and Policy Analysis
Gregory J. Petesch, Director, Legal Services Office**

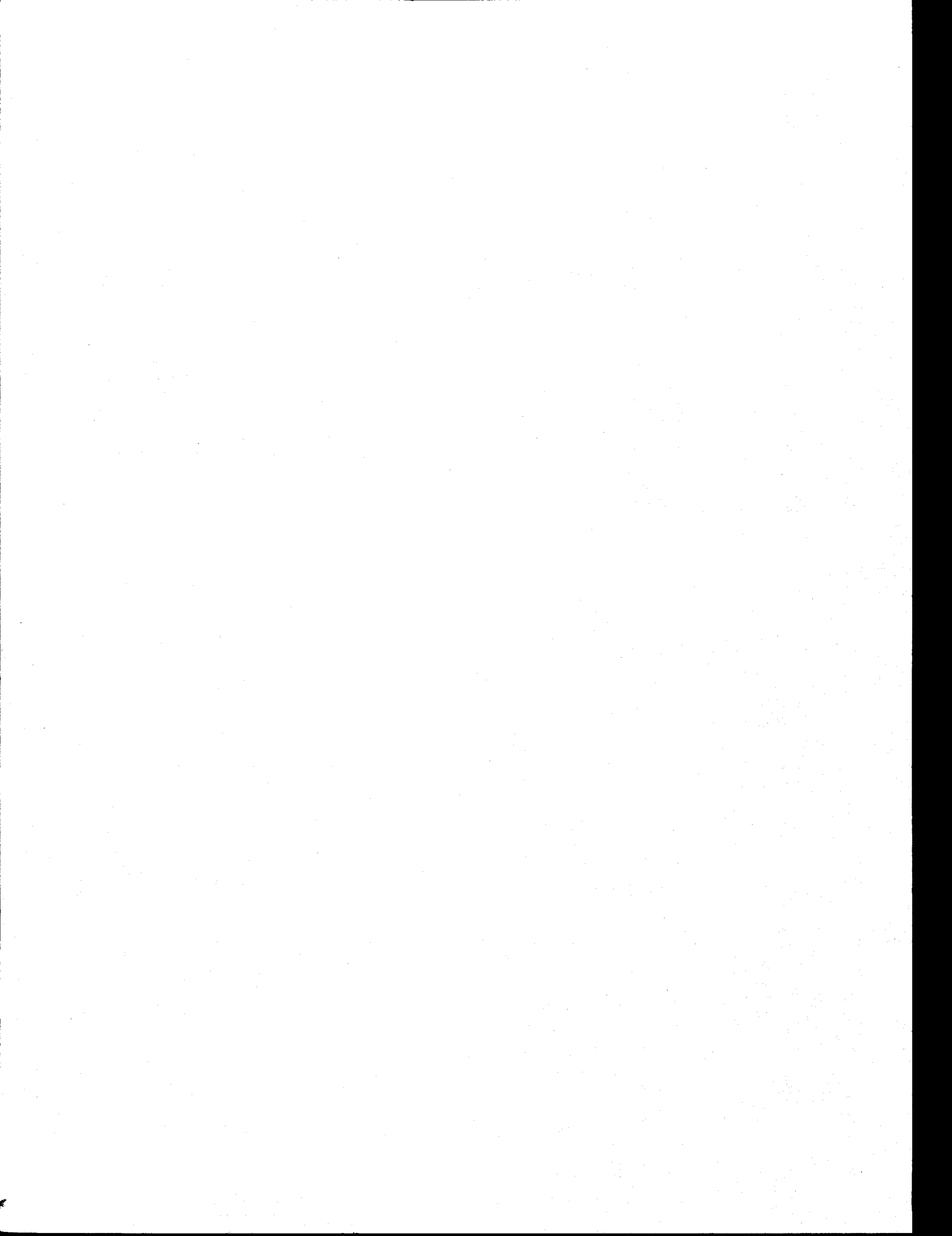


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TAC Final Report: Executive Summary

- Some parts and phases of the restructuring process proceeded in accordance with the schedule set forth in Senate Bill 390, while others did not. Deadlines for the Public Service Commission's final orders on utility transition plans and the start date of pilot programs were necessarily delayed.
- The Transition Advisory Committee (TAC or Committee) was responsive to unanticipated decisions and events, such as the Montana Power Company's announcement of its intention to sell all of its generation assets in the state.
- The TAC met its statutory requirements regarding quarterly meetings and reports, and conducted an additional meeting in conjunction with the Montana Consumer Counsel.
- The TAC established the Education Subcommittee to ensure that other TAC members and interested legislators were informed about basic aspects of restructuring in Montana and elsewhere and to monitor and evaluate the fairness and effectiveness of customer education messages and materials produced by investor-owned utilities and participating electrical cooperatives.
- The TAC established the Universal System Benefits Program (USBP) Subcommittee to develop and recommend a practical means of collecting and administering USBP funds as well as to find a method for determining the applicability of credits against universal system benefits charges.
- The TAC considered and heard public comment on a variety of issues arising from restructuring. Some of these issues were of central importance, including customer aggregation and barriers to competition, while others were more peripheral to the scope of SB 390, such as water rights and continued access to recreational property.
- Because important aspects of electrical industry restructuring are to be phased in over a number of years, relatively few matters could be concluded or resolved during the 1997-98 interim; therefore, the Committee's legislative recommendations are few in number. They include detailed draft legislation to structure the USBP and a proposal to repeal the reciprocity provisions of SB 390.

TRANSITION ADVISORY COMMITTEE FINAL REPORT

I. Introduction and Overview

Senate Bill 390 (Chapter No. 505, Laws of 1997)* established the Electric Utility Industry Restructuring Transition Advisory Committee (TAC or Committee) composed of 20 members, 8 of whom are voting members, 4 each from Montana's House and Senate, with an equal number of Republicans and Democrats. The other 12 members were appointed by the governor to fulfill advisory functions as representatives of groups in Montana with an interest in the restructuring process. *(See Appendix I for a list of members and their affiliations.)*

SB 390 is a relatively complicated legislative package, not readily understood by Montana citizens who did not participate in or observe the bill's rites of passage during the 1997 session. The Committee made extensive use early on of several synopses of the bill, one of which is included in this report (see *Appendix II*), and can also be found at the Public Service Commission's (PSC) website at www.psc.state.mt. One of the foremost challenges faced by the TAC was to better educate its own members on the intricacies of the bill, as well as some of the speculative aspects of restructuring that the law itself could not (and still cannot) address with any degree of certainty. The predictive power of the TAC has been constrained by limited knowledge of the future of electricity prices, the sources, types, and long-term availability of reliable electricity supplies, and the shape energy markets will actually take in a changed economic and technology-influenced environment.

The membership of the TAC reflects the different groups in the state with an interest in the outcome of restructuring. Stakeholders in the process include producers and purveyors of electricity, such as investor-owned utilities and electrical cooperatives, as well as electricity consumers of various sizes and types, including large industrial firms, public entities, small commercial enterprises, and residential customers. Under

* Codified as Title 69, chapter 8 in the Montana Code Annotated.

regulation, the interests of producers and consumers are largely congruent, or at least held together in a balanced fashion through the rulings and good offices of the PSC. With partial deregulation, firms in the generation segment of the production side are free to pursue business interests that may be quite disparate from those of many customers. Market forces are believed to be the best means of achieving the balance that was formerly struck by regulation.

Legislative passage and implementation of Montana's electrical industry restructuring bill did not occur in a vacuum. California and New Hampshire were early pioneers in this venture. While different in many obvious respects, the industries and communities in both these states were burdened with relatively high energy costs. Montana was the first low-cost energy state to go forward with restructuring. As of April 1998, an additional seven states had enacted restructuring legislation, another seven had moved decisively toward restructuring through the issuance of comprehensive regulatory orders, ten states had legislation or orders pending, and 23 states had some sort of study commission in place to investigate feasibility. South Dakota was alone among the 50 states in not having authorized any significant restructuring activity.* Meanwhile, several bills are pending in the U.S. Congress to establish restructuring on a nationwide basis, although there is considerable resistance among states to preemptory action by the federal government.

The Committee is authorized to make legislative recommendations. Under a general provision of SB 390, the TAC "shall recommend legislation if necessary to promote electric utility restructuring and retail choice of electricity suppliers."^{***} The law mandates such action in only one general arena, however, during the 1997-98 interim. A provision of SB 390 requires the TAC to make recommendations to the governor regarding the implementation of statewide universal system benefits charges on or before January 1, 1999, and a related feature of the bill requires the TAC to make recommendations to the governor and the Legislature regarding low income energy

* Source: Energy Information Administration, U.S. Dept. of Energy: www.eia.doe.gov

** See 69-8-501(13), MCA.

assistance derived from all energy providers in the state.* As is documented later in this report, the Universal System Benefits Program (USBP) Subcommittee of the TAC developed guidelines and recommended them to the full Committee for consideration and for formal recommendation to the entire Legislature.

Other legislative recommendations are likely to emerge in the future, as the complicated restructuring process evolves. For example, the TAC's Education Subcommittee will continue to monitor activities that could lead members to suggest changes in the law regarding who is ultimately responsible for customer education and/or what type and amount of funding may be required to effectively inform customers of what their choices are in the nascent market for retail electricity supply and services. In addition, legislation will probably be required to make more certain who will bear responsibility for providing electricity to consumers who for one reason or another fail to make a deliberate choice of power supplier at the end of the transition period.

There are a number of unanswered questions and unresolved issues to be addressed in subsequent phases of the restructuring process. For example, whether metering and billing services must be unbundled from distribution charges and the extent of the PSC's jurisdiction regarding the distribution of proceeds resulting from the sale of formerly regulated utility assets are issues that arise in the review of transition plans that utilities are required to file with the PSC under SB 390. In addition, as the text of the restructuring bill spells out, there is an anticipated sequence of required activities, such as transition plans, pilot programs, the licensure of suppliers, the unbundling of utility bills. However, as this first phase of the process illustrates, there have been several surprising turns of events that were not anticipated by the bill's supporters or the Committee members.

The Montana Power Company's (MPC) announced intention to sell its generation facilities in December caused the schedule of hearings and related meetings to change. A later decision by MPC to dissolve its electricity marketing affiliate and then PacifiCorp's decision to sell its transmission and distribution system in the northwestern

* See 69-8-501(14) and 69-8-501(18), MCA.

part of the state caused additional delays in what had earlier been expected to be a smooth transition. There may be further surprises down the road, as restructuring proceeds in other western states and across the country as a whole. Even when the aforementioned sales have been completed, there will still be complicated matters to deal with, including the disposition of any remaining stranded costs, determining who will be designated the supplier of last resort, if and how Independent System (or Grid) Operators will be established and maintained, and whether the FERC relicensing procedures will have any effect on existing water rights and public access to recreational sites contained within or located adjacent to utility property boundaries.

On November 3, 1998, after the TAC's last meeting and just as this final report was being prepared for printing, the Montana Power Company announced that it had successfully negotiated the sale of its hydroelectric facilities and its coal-fired production plants to Fairfax, Virginia-based PP&L Global, a subsidiary of Pennsylvania Power and Light Resources, Inc. The sale price of \$988 million was above the estimated \$550 million book value of the generation assets. MPC pledged at several TAC meetings to return to former ratepayers funds derived from the sale in excess of book value and the company's transaction costs, estimated at \$50 million. While the sale ended months of speculation as to the identity of the purchaser, the exact identification of what was being sold, and the purchase price, uncertainty abounds as to whether all former MPC employees will be retained by the new owner and whether there are still stranded costs issues to resolve. The sale will likely not be completed until sometime in 1999, so it is unlikely that any associated problems will be addressed by the 56th Legislature.

No general conclusions are set forth in this report. This brief overview and the descriptive sections below, along with the substantive appendices, should give the reader a fairly comprehensive view of the TAC's purposes, processes, and accomplishments.

II. Budget Summary

In SB 390, the 1997 Legislature authorized the Legislative Services Division to receive gifts, grants, and donations to offset the Committee's costs and also appropriated up to \$200,000 of the funds for the biennium. Donations from MPC, PacifiCorp, and the Montana Electric Cooperatives Association totaled approximately \$79,000 in the 1997-98 interim, and expenditures (prior to the submission of this final report for printing and distribution) amounted to about \$44,000. Under SB 390, the remainder of unexpended funds will be returned to the donors on a proportional basis.

III. Chronology of TAC Activities and Events

The Committee met as a whole nine times, once more than expected at the outset of the 1997-98 interim. The date and location of each meeting is listed below, along with very brief synopses of the topics addressed. In some cases, the synopsis will refer to a specific document included as an appendix to this report; in others, readers are advised to consult the official minutes (available from Legislative Services Division staff) for further details.

JULY 11, 1997, Helena

The Committee elected a chair and vice chair (Senator Thomas and Representative Ryan, respectively), reviewed the budget, and provided informational updates on the status of transition plans filed by utilities with the PSC, the position and perspective of electrical cooperatives, and on conferences that several members had attended. Staff provided an overview of statutory duties and optional methods of fulfilling them. A calendar of prospective meeting dates was adopted, and the task of developing a comprehensive work plan for the duration of the interim was assigned to a subcommittee.

OCTOBER 6-7, 1997, Billings

The main agenda items were Customer Aggregation (strategies and opportunities to create purchasing pools), Reciprocity (with neighboring states), and Market Power issues (e.g., impediments to new entrants in the supply segment of the electricity market). The Committee also heard a presentation on the historical evolution of the electrical industry in Montana by selected members as well as invited representatives from MPC, the Northwest Power Council, and the Electric Cooperatives. A subsequent panel informed the Committee about various energy assistance programs in place in Montana. An additional topic at the meeting was the economic and other practical feasibility of fuel cell technology in a restructured electricity market.

JANUARY 9, 1998, Helena

The Committee held a special joint meeting with the Consumer Counsel to consider the ramifications of MPC's December 9 announcement that it intended to sell all of its generation assets (hydroelectric dams and coal-fired plants) in the state. The combined body heard presentations by MPC, the PSC, and staff from the Department of Revenue on the rationale for the sale; the expected effects on industrial, small commercial, and residential customers; the consequences for the transition plan filing requirements under SB 390; and the state and local tax ramifications. Issues related to the possible impacts on fish and wildlife resources were also raised. The prospect of state purchase of MPC's Missouri system dams was raised by Senator Mike Sprague who had also brought the matter to the attention of the Legislative Council.

FEBRUARY 6, 1998, Missoula

The meeting began with a public comment period and proceeded with subcommittee reports and members' and staff updates. There was a panel presentation on the status of efforts to establish power purchasing pools through customer aggregation. On this topic, the Committee heard from representatives of the University System, the Montana Association of Counties, the Montana Hospital Association, the Montana School Board Association, the Montana Automobile Dealers Association, and the Montana Environmental Information Center. A further panel discussion involved marketers and suppliers of electricity on the issue of barriers to entry into the retail market. Presenters included MPC, Montana-Dakota Utilities, the cooperatives, PacifiCorp, Enron, Commercial Energy, and the Bonneville Power Administration. A final panel discussed the reciprocity provisions of SB 390, and staff provided a legal memorandum on the issue. (*See Appendix III.*)

MARCH 13, 1998, Helena

At a meeting that was focused primarily on issues linked to the pending sale of MPC's generation assets, there was a series of informal panel discussions that dealt with electricity prices, stranded costs, potential job and tax revenue losses, water rights, recreational access, and fish and wildlife management in relation to the Federal Energy Regulatory Commission's relicensing of hydroelectric facilities on the Missouri River system. A question period devoted to electricity prices featured comments from a member of the Northwest Power Planning Council staff, another from the staff from the Consumer Counsel, and several individuals representing different electric cooperatives and energy supply firms. A similar period concerning water-related issues involved testimony from persons representing the state's Departments of Natural Resources and Conservation; Environmental Quality; and Fish, Wildlife, and Parks. An additional time slot was assigned to considerations of employment and revenue questions and involved personnel from the Montana AFL-CIO, the International Brotherhood of Electrical Workers, an elected Commissioner from Rosebud County, the Montana

Department of Revenue, and local government officials from Helena and Great Falls.
(See Appendix IV for a descriptive summary of the issues discussed at this meeting.)

APRIL 24, 1998, Great Falls

The Committee heard three presentations, one concerning the Clinton Administration's proposal to offer consumer choice on a nationwide basis, another on California's experience to date with restructuring, and a third on a proposal from the Montana League of Cities and Towns to facilitate electricity purchasing by municipal governments.

JULY 24, 1998, Sidney

Members of the public were provided an opportunity early in the meeting to make comments on and ask questions about the restructuring process. The discussion evidenced diverse concerns about the situation in northeastern Montana, where local cooperatives have so far opted not to open their territories to competition and where Montana-Dakota Utilities is not required, under SB 390, to offer customer choice in electricity supply until 2006. The electrical power needs and interests of predominantly rural agricultural consumers were the main focus of attention. In addition, a consulting economist from the National Rural Utilities Cooperative Finance Corporation made a presentation outlining the difficulties of "unbundling" metering and billing services from the distribution portion of a utility's service functions. The Committee later discussed a list of potential legislative recommendations prepared by staff.

SEPTEMBER 18, 1998, Helena

This penultimate meeting of the TAC was devoted primarily to discussions on how best to wrap up the Committee's assorted tasks in advance of the November 1 report deadline prescribed in SB 390. Members provided updates on the status of MPC's sale of generation assets as well as some legal complications associated with PacifiCorp's proposed sale of its transmission and distribution to Flathead Electric. Legislative staff supplied a brief summary of optional approaches taken by the Revenue Oversight Committee to address potentially offsetting tax losses and gains resulting from the aforementioned sales and other aspects of restructuring. The Committee also heard reports and recommendations from the Education Subcommittee and the USBP Subcommittee (summarized elsewhere in this document). The possible reorganization of interim committees following the 1999 session, and the effect this structural change may have on the future composition and operations of the TAC was also discussed briefly.

OCTOBER 23, 1998, Helena

The Committee was briefed on the status of MPC's pending negotiations with an unnamed prospective buyer or consortium of buyers. Because of the confidential nature of these negotiations, the most that the Committee could learn was that a purchase was imminent and would be announced as soon as possible. Next, the Committee was apprised by PacifiCorp attorneys and PSC staff of the legal dispute connected to the utility's surprise decision to sell its distribution system in Montana to Flathead Electric Coop. The PSC takes the position that it has jurisdiction over the terms of the sale, especially with regard to the disposition of negative stranded costs (also known as stranded benefits). PacifiCorp claims that the PSC does not have jurisdiction. The matter was referred to District Court, which at the time of this writing, had imposed an injunction on the sale pending further negotiation between the parties.

The Committee heard a detailed explanation from staff and Rep. Bergsagel of draft legislation to implement the USBP mandated by SB 390. Other TAC members and

interested persons who had participated in the subcommittee deliberations of this topic provided further testimony and support for the proposed bill, which subsequently gained a formal recommendation from the voting members of the TAC.

After a short introduction by staff of the draft final report on TAC's interim activities, several items in (or missing from) the draft were discussed; afterwards, staff were authorized to add to and complete the report, the published version of which will be provided to each legislator and made available to interested persons on request.

Other substantive discussions touched on the possible establishment of a statewide power purchasing cooperative to improve the leverage of small commercial and residential customers as well as perform, possibly, as the default supplier of last resort. Legislation will be needed to authorize such a cooperative, especially if it is empowered to take on former MPC customers who decline to exercise choice when that option is available in 2002 or sooner. The Committee voted to recommend repeal of the reciprocity provision of SB 390* and to combine all of the legislative recommendations into a single bill draft. Finally, the Committee agreed that the composition of the TAC should remain intact, notwithstanding any structural changes to interim committees as a whole that might result from actions taken by the 56th Legislature.

Other Related Events

A number of meetings pertinent to the Committee took place during the interim and were attended by members and staff alike. For example, the Helena Citizens' Commission sponsored a seminar on related issues in November 1997. In February 1998, the city of Great Falls held a day-long meeting to consider the feasibility of municipal purchases of several of MPC's Missouri River hydroelectric plants, and the Helena City Commission also looked into the possibility of buying Holter and Hauser dams. On April 16, 1998, Governor Racicot sponsored a public forum in Helena for the

* See 69-8-411, MCA.

purpose of discussing the ramifications of MPC's decision to sell its generation facilities as well as other matters related to restructuring. Meanwhile, a number of state legislators concerned about the consequences of unpredicted aspects of restructuring called for a 1-day special session in March, 1998, but failed to muster enough votes. A number of citizens' groups also proposed a ballot initiative that would have required the state to use its powers of condemnation to buy MPC's water rights in order to keep them subject to public, rather than private, control.

On July 1, 1998, large industrial customers of MPC and PacifiCorp were free, under a provision of SB 390, to choose their electricity supplier.* Holnam Cement and Conoco Pipeline switched from MPC to Villanova, while Stone Container opted to stay with MPC. At the time of this writing, a number of other large consumers are negotiating with licensed power marketing firms for new supply contracts.

Following a period of temporary licensing procedures, the PSC established formal conditions. As of this writing, only four companies had become licensed. Uncertainties—the sale of MPC generation facilities, unresolved stranded cost issues and, supplier of last resort—have effectively reduced suppliers' incentives to serve the Montana market.

*69-8-201, MCA provides that all customers with individual loads at a meter greater than 1,000 kilowatts and customers whose combined individual loads of 300 kilowatts or more each aggregate to a total of 1,000 kilowatts or more were entitled to choice on July 1, 1998.

IV. Abstract of Substantive Achievements & Works in Progress

For the sake of efficiency and effective analysis of key issue areas, the Committee was subdivided into two subcommittees and two (smaller) working groups. The Education Subcommittee was assigned the general tasks of monitoring and evaluating customer education materials and pilot programs devised by utilities in accordance with provisions in SB 390. This Subcommittee was responsible for reviewing each issue of the quarterly newsletter* before publication, and also later accepted the delegated responsibility to help inform the TAC as a whole about various restructuring issues, including water rights. The USBP Subcommittee was responsible for meeting the detailed requirements in SB 390 regarding benefits and charges that will still be required of utilities during the transition to a partially deregulated market environment. The bill established a USBP fund "to ensure continued funding of and new expenditures for energy conservation, renewable resource projects and applications, and low-income energy assistance during the transition period and into the future." The charge of the Subcommittee is to analyze the issues associated with the USBP fund and make recommendations to the full TAC regarding fund implementation in order to fulfill the TAC's statutory requirements.

The Public Service Commission Liaison Group was assigned to monitor PSC activities as well as analyze the issues of customer aggregation, the licensing of electricity suppliers, and the reciprocity provisions of SB 390. This group met twice during the interim (November 21, 1997, and January 16, 1998) and reported to the full TAC. The Revenue Oversight Liaison Group was established to maintain communication with the Revenue Oversight Committee (ROC), which under SB 390 undertook an analysis of "the amount of state and local tax revenue derived from previously regulated electricity suppliers that will enter the competitive market and report to the legislature annually on how revenue to the state or local government is changed by restructuring and competition." The ROC was further charged by SB 390 to recommend legislation, if

* The TAC Report was recommended by the Education Subcommittee and adopted by the full Committee as a means of fulfilling a quarterly reporting obligation established by SB 390. See Appendix V for the full text of each TAC Report.

necessary, to address possible revenue losses and tax shifting resulting from restructuring. (See forthcoming final report of the ROC for details.)

The Education Subcommittee

Members of this subcommittee are Dave Wheelihan, chair (Montana Electrical Cooperatives Association), Senator Fred Thomas, Bob Nelson (Consumer Counsel), Stephen Bradley (Crow Tribe), and Roma Taylor (citizens' advocate). The Education Subcommittee met four times during the interim. A brief accounting of its activities follows.*

January 22, 1998: The Subcommittee's first meeting took place in the State Capitol in Helena. The primary focus of the meeting was a preliminary education project called The Collaborative, which had been initiated in the fall of 1997 by the Montana Power Company. The Collaborative was facilitated by Gerald Mueller of Consensus Associates, and involved voluntary participation by representatives of the PSC, the Bonneville Power Administration, the Department of Environmental Quality, the Department of Health and Human Services, PacifiCorp, the Montana Electrical Cooperatives Association, Energy Share, and the TAC staff. (To view the outcome of the Collaborative process, see Appendix VI.)

March 24, 1998: The Subcommittee met at the State Capitol in Helena to obtain updated information on the status of the pilot programs and customer education plans mandated by SB 390. The members also explored the issues of "standard offer" provisions in contracts between licensed suppliers and customers and whether metering and billing services would necessarily be offered to customers on a competitive basis. Another topic of discussion was the need to better inform the public about the distinctions between wholesale electricity deregulation fostered by federal

*For more detail, the minutes from each meeting are available from Legislative Services Division staff.

laws and policies and the partial deregulation of the retail electricity market under the provisions of SB 390.

July 1, 1998: The Subcommittee met in Helena and discussed the continuing uncertainty regarding the practical ramifications of the TAC's self-imposed responsibility to help educate beyond its members and the Legislature as well as a seemingly inherent conflict arising from the difficulty of distinguishing education from marketing and other, more subtle, forms of self-dealing (which is proscribed by SB 390).

The Subcommittee resolved to serve as a clearinghouse for education materials. Utilities and Cooperatives were asked to supply the members (via staff) with samples of all their relevant education materials (print and video) to date, so that the Subcommittee could evaluate the effectiveness and fairness/neutrality of the information provided to the public.* The Collaborative agreement on the basic education "message" and the relevant provisions of SB 390 will provide the basis for evaluation. Other evaluation tools gleaned from the literature and Subcommittee members' experience may be used as supplements. The actual use of these collected criteria remained an open question. For example, the Subcommittee could find that the utilities' and opted-in cooperatives' messages are both fair and effective and therefore not make any recommendation to the full TAC for any legislative modifications. Conversely, the materials may appear biased or inadequate in some way, thereby compelling the Subcommittee to recommend to the TAC that a third party (such as the PSC or the Consumer Counsel) be designated in statute as taking responsibility for customer education during the remainder of the transition period. The Subcommittee acknowledged that any recommendation to alter the education mandate in the restructuring legislation would raise the issues of who would fund the effort, and how much funding would be adequate to the task.

* Materials from the Electrical Cooperatives were presented at this meeting, and a preliminary draft of an MPC brochure was also analyzed and discussed.

September 17, 1998: The Subcommittee met in Helena to review utility education materials and consider water rights issues. Chairman Wheelihan informed the members that the Montana Electric Cooperatives Association is considering the inclusion of customer education efforts in its budget. MPC representatives brought sample brochures (which were subsequently mailed to customers) containing information for primarily residential consumers about how to get involved in the early (pilot) stages of the transition, and also brought as an example of an effective education campaign a series of video clips that were used by a Pennsylvania utility. In addition, a representative from Xynergy Corporation (which contracts with MPC for research on retail choice and other services) was on hand as a resource person and provided members with a packet of educational materials.

The Subcommittee discussed a number of questions, including the following:

- ◆ What needs to be contained in the media messages to customers?
- ◆ What constitutes a fair, unbiased, message that nonetheless provides customers with information specifically relevant to their choices now and in the future?
- ◆ What are the principles and parameters that can best guarantee an effective message—one that is clear, concise, memorable, attractive, and easy to understand?
- ◆ Will MPC, PacifiCorp, and the Cooperatives continue to deliver the same kind of messages under changed circumstances, such as MPC's exit from power supply and PacifiCorp's divestiture of distribution?
- ◆ What do customers need to know now and in the months to come about restructuring and, more specifically, about who their potential suppliers are and what sort of price/value comparisons can be made?
- ◆ Given the nature and extent of unanticipated business decisions and considering the scope of unresolved issues surrounding restructuring, are the utilities still the appropriate responsible party for customer education?

On the subject of water issues, the Subcommittee heard a presentation by Senator Hurwitz and then invited comments and responses from representatives from the Department of Natural Resources and Conservation and MPC. (*See Appendix VII for background information.*) Members also noted that the Governor's Office has requested that the Federal Energy Regulatory Commission take into consideration, in the course of its hydroelectric facilities relicensing procedures, the potential impacts of a new owner's assertion and actual use of senior water rights on the primarily agricultural junior water rights holders in the Missouri Basin.

In sum, without formalizing specific recommendations to the full TAC for legislative changes, the Education Subcommittee intends to continue careful monitoring and evaluation of customer education materials produced by utilities and the cooperatives and will encourage both entities to cooperate with each other (and the TAC) to generate fair, accurate, and effective messages to the public about restructuring.

The Universal System Benefits Program Subcommittee

In enacting SB 390, the 1997 Legislature created a USBP fund. Annually, starting January 1, 1999, each utility/cooperative must contribute 2.4% of its 1995 retail sales revenue, which is established for each utility and cooperative as its annual USBP fund level. A utility's or cooperative's minimum annual funding requirement for low-income energy and weatherization assistance is established at 17% of the utility's or cooperative's annual USBP funding level. SB390 provides for utility, cooperative, and large customer credits against their contributions to the USBP fund, and cooperatives may collectively pool their statewide credits.

The purpose of the USBP fund, according to SB390, is "to ensure continued funding of and new expenditures for energy conservation, renewable resource projects and applications, and low-income energy assistance during the transition period and into the future." In addition to cost-effective energy conservation, renewable resource projects and applications, and low-income energy assistance, SB 390 defines USBP to also include "research and development programs related to energy conservation and renewables."

Under SB 390, the TAC is required to make recommendations before January 1, 1999, to the Governor, regarding the implementation of the USBP fund.

At its October 6 and 7, 1997, meeting, the TAC established the USBP Subcommittee. Representative Ernest Bergsagel was named Chairman. The other members are Don Quander (representing large industrial customers), Kathy Hadley (environmental and conservation interests), Gene Lewer (low income programs), and Perry Cole (investor-owned utilities). The charge of the USBP Subcommittee is to analyze the issues associated with the USBP fund and make recommendations to the full TAC regarding fund implementation in order to fulfill the TAC's statutory requirements.

TAC USBP Fund Statutory Directives :

Under 69-8-501(14), MCA, the TAC:

shall make recommendations to the governor, regarding the implementation of statewide universal system benefits and universal energy assistance funds, in time to allow for those funds to be created on or before January 1, 1999. This may include recommendations regarding the assignment of an existing government agency or private, nonprofit entity as the fund administrator and administration guidelines for the funds, including the means by which funds may be made available for use.

Under 69-8-501(18), MCA :

On or before November 1, 1998, the transition advisory committee shall make recommendations to the governor and the legislature regarding the provision of low-income energy assistance programs in Montana by all energy providers.

USBP Subcommittee Action:

The USBP Subcommittee met 11 times during the 1997-98 interim and hammered out three comprehensive sets of recommendations:

(1) Guidelines on what should qualify for a USBP credit or expenditure (See *Appendix VIII*).

(2) Proposed legislation regarding the implementation of statewide universal system benefits and universal energy assistance funds and the enforceability of USBP credits (See *Appendix VIII*).

(3) The USBP Subcommittee recommended the TAC pursue a method to assess a fee for all fuels during the 1999-2000 interim.



APPENDIX 1



TRANSITION ADVISORY COMMITTEE MEMBERS 1997-1999

Rep. Ernest Bergsagel
HC 84 Box 8045
Malta, MT 59538-9701
Ph: 658-2154

Sen. Walter McNutt
110 12th Ave. SW
Sidney, MT 59270-3614
Ph: 482-4400

Rep. Larry Hal Grinde
RR 3
Lewistown, MT 59457-9803

Sen. J. D. Lynch
527 W Mercury St.
Butte, MT 59701-1629

Rep. Joe Quilici
3040 Kossuth St.
Butte, MT 59701-6336
Ph: Wk 723-3258 Hm 782-5772

Rep. Bill Ryan
8 18th Ave S
Great Falls, MT 59405-4113
Ph: 761-8333

Sen. Fred Thomas, Chair
3566 Holly Lane
Stevensville, MT 59870-6634
Ph: 777-5005 Fax 777-5004

Sen. Bill Wilson
1305 2nd Ave. N.
Great Falls, MT 59401-3265

Bob Anderson
Public Service Commission
P.O. Box 202601
Helena, MT 59620
Ph: 444-6169

Stephen Bradley
2024 Third Ave. N.
Billings, MT 59101

Perry Cole
Montana Power Co.
40 East Broadway
Butte, MT 59701
Ph: 497-3247

Al Davis
MT Dept. of Environmental Quality
1520 E Sixth Ave.
Helena, MT 59620
Ph: 444-6756

Stan Dupree, Business Manager
IBEW-Local 44
P.O. Box 3467
Butte, MT 59702

Kathy Hadley
P.O. Box 3838
Butte, MT 59702

Judi Johansen
Avista Energy
101 SW Main, # 1870
Portland, OR 97204-3228

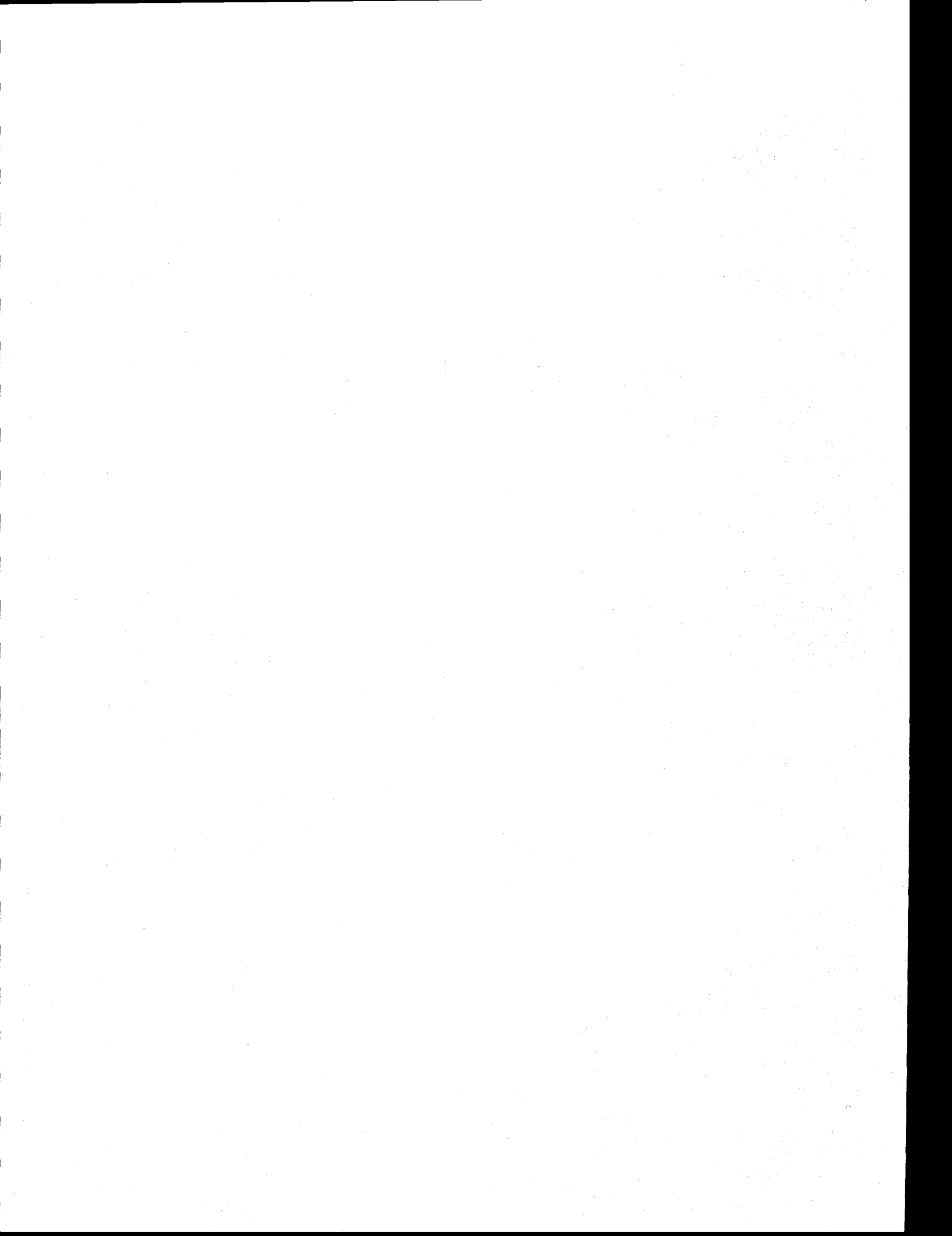
Gene Leuwer
Rocky Mountain Development Council
P.O. Box 1717
Helena, MT 59624

Bob Nelson
MT Consumer Counsel
34 West Sixth Ave.
Helena, MT 59620
Ph: 444-2771

Don Quander
Holland and Hart
401 N. 31st St., Suite 1500
Billings, MT 59101
Ph: 252-2166, Fax 252-1669

Roma Taylor (citizen's advocate)
P.O. Box 1423
Bigfork, MT 59911

Dave Wheelihan
MT Electric Cooperatives Assn.
Box 1306
Great Falls, MT 59403
Ph: 761-8333



APPENDIX 2



**THE MONTANA ELECTRIC UTILITY INDUSTRY RESTRUCTURING AND
CONSUMER CHOICE ACT
Senate Bill 390**

SUMMARY

Customer choice. (Sections 4 & 5) On or before July 1, 1998 investor owned electric utility customers with loads greater than 1000 kilowatts or a customer with loads greater than 300 kilowatts per meter that aggregate to 1000 kilowatts or greater must have the opportunity to choose an electric supplier.

a. As soon as administratively feasible, but before July 1, 2002, all remaining investor owned utility customers must have choice.

b. The Public Service Commission (PSC) may extend the date for 2 years if it finds that it is not administratively feasible or that there isn't workable competition.

c. Beginning July 1, 1998, utilities must run pilot programs offering customer choice for residential and small commercial customers.

d. Montana Dakota Utilities may defer choice for its customers until 2006.

Investor owned utility transition plan filing. (Sections 6 & 7) Investor owned utilities must file a transition plan with the PSC 1 year before any customer is entitled to choice.

a. The PSC must hold a contested case proceeding on the plan and afford all parties the opportunity for a hearing before issuing a final order either approving, modifying, or denying the plan.

b. The PSC must make a decision on the plan within 9 months, unless waived by the utility.

c. The transition plan must contain: an outline for an orderly transition to choice for all customers, a method for assigning customers that do not chose suppliers, an educational program for their customers, and a plan for implementing universal system benefits programs.

Investor owned utility functional separation. (Sections 8, 9 & 10) Investor owned utilities must functionally separate the utility's electricity supply, transmission, distribution and energy services operations.

a. The utility must make its transmission and distribution facilities available for all electricity suppliers and customers on a nondiscriminatory and comparable basis.

b. The utility must adopt and comply with a code of conduct consistent with the Federal Energy Regulatory Commission's code of conduct.

Investor owned utility power supply during the transition. (Section 11) On the effective date of the PSC's order, an investor owned utility must remove it's generation assets from rate base.

a. During the transition to choice, the utility may offer cost-based supply service for those that do not have choice or have not chosen.

b. If the transition period is extended, the PSC will continue to regulate the provision of electricity supply.

c. If an investor owned utility intends to be an electricity supplier through an unregulated affiliate, the affiliate must be licensed as a supplier.

Investor owned utility transition cost recovery. (Section 12) The PSC shall allow recovery of transition costs. The costs that may be recovered include:

a. The unmitigable above market costs of qualifying facility contracts, including buy out or buy down costs;

b. The unmitigable costs of energy supply related regulatory assets and deferred charges; and

c. For a 4 year period, the unmitigable costs of investor owned utility owned generation and power purchase contracts.

d. The utility must make reasonable efforts to mitigate the costs

e. Upon PSC approval the transition costs are to be recovered through a non bypassable charge on all customers (except on those customers with new loads greater than 1000 kilowatts which were first served by the utility after December 31, 1996).

Investor owned utility rate moratorium. (Section 12) An investor owned utility shall institute a rate moratorium during the transition to competition.

a. Beginning July 1, 1998 there is a 2 year rate moratorium for all customers.

b. After June 30, 2000, rates for customers that do not have choice, as of July 1, 1998, cannot be increased, except for transmission and distribution rates subject to PSC approval. Power supply costs may not increase for these customers until after June 30, 2002.

c. There are moratorium exemptions for: increased universal systems benefits charges in excess of current revenues; for an extraordinary event resulting in a 4 percent or more increase in annual revenue requirement--8 percent of power supply costs in the last two years of the rate moratorium, and for increases or decreases in state and federal taxes in excess of rates of inflation.

d. During the transition, public utilities may not charge rates or collect costs higher than they would reasonably expect to recover in rates if the current regulatory system had remained intact.

Rural electric cooperative option of choice. (Sections 13-20) Rural electric cooperatives have the choice of opting in or out of offering their customers choice.

a. If a cooperative opts in, it must certify to the PSC that it has adopted a transition plan consistent with the provisions of the act, but essentially the same as the investor owned utilities.

b. If a cooperative opts out, it is precluded from accessing the distribution system, and thus customers, of other utilities that have opened their system up without a preexisting contract.

c. A cooperative must participate in the universal systems benefits program whether it opts in or out.

Universal systems benefits programs. (Section 22) Universal systems benefits programs are established. A charge will be paid by all utility customers (assessed at the meter) to ensure continued funding of energy conservation, renewables and low-income energy assistance programs.

a. Beginning July 1, 1999 and until July 1, 2003, 2.4 percent of each utility's 1995 retail sales revenue is established as the annual funding level for universal systems benefits programs.

b. A minimum annual funding requirement for low income energy bill and weatherization assistance is established at 17 percent of each utility's annual universal system benefits funding level.

c. The annual charge for customers with loads greater than 1000 kilowatts is the lesser of \$500,000 or .9 mills per kilowatt hour purchased.

d. Utilities and large customers receive credit toward their universal system benefits obligation for their internal programs.

e. If a utility's or a large customer's credit does not satisfy the annual funding requirement, then it shall make a payment to the universal systems benefit fund or the universal energy assistance fund.

f. Cooperatives may collectively pool their credits statewide.

g. Investor owned utilities and cooperatives must file annual reports relating to universal systems benefits to the transition advisory committee created by this bill.

Public Service Commission regulatory responsibilities. (Section 23) The PSC shall continue to regulate the retail transmission and distribution system within Montana after it issues a final order on a utility's transition plan.

a. The PSC may find that workable competition does not exist and continue the regulation of electricity supply by distribution services providers for a period of no more than 3 years, past the transition period.

b. The PSC must determine whether competition is sufficient to inhibit monopoly pricing or anticompetitive price leadership.

Licensing of electricity suppliers. (Sections 24-28) The PSC shall license electricity suppliers and enforce their licensing provisions.

a. All electricity suppliers must be licensed by the PSC before offering to sell to customers in Montana.

b. The PSC must make sure that electricity supply is offered and is adequate in terms of quality, safety, and reliability.

c. The PSC may suspend the license, impose penalties, or both if the PSC finds the electricity supplier violates the provisions of this act.

d. Slamming or unauthorized switching of customers is specifically prohibited.

e. Electricity bills must disclose costs to customers of each cost component.

f. Reciprocity is required to obtain access to another utility's distribution facilities.

Legislative transition oversight committee on electricity restructuring. (Section 29) A legislative transition oversight committee on electricity industry restructuring is created.

- a. There are 8 voting legislative members, two from each house from each party.
- b. There are 12 nonvoting advisory members from industry, customer groups, and other affected interests.

c. The transition oversight committee shall analyze and report to the Governor and members of the legislature on the status of electricity industry restructuring in the state, the transition to effective competition, the need for further consumer protections in the state, recommend legislation to further promote restructuring, and make recommendations on universal systems benefits programs.

Tax study. (Section 30) The revenue oversight committee is to analyze the tax implications of restructuring and report to the Legislature with legislative recommendations on the statutory tax changes that are necessary as a result of restructuring.

Transition bond financing. (Section 31) Utilities may apply to the PSC for a financing order to issue transition bonds to recover certain transition costs.

- a. The cost savings from issuing bonds must benefit customers.
- b. The bonds are secured by a non bypassable charge on all customers that creates a revenue stream to pay interest and retire the bonds.
- c. The bond term must not exceed 20 years.
- d. Rural electric cooperatives that opt in may also bond for recovery of transition costs.

Territorial integrity act modifications. (Sections 32-44) The territorial integrity act is modified from who has responsibility to serve loads to who has responsibility to connect the load.

- a. The Act creates a rebuttable presumption that the nearest line is the least-cost line to build.
- b. There are provisions for the PSC to approve agreements between competing utilities that might serve the same loads.
- c. There are special provisions for dealing with annexed new areas of cities.

Note: The effective date of SB 390 is May 2, 1997.

APPENDIX 3





Electric Utility Industry Restructuring Transition Advisory Committee

Room 138 State Capitol
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

55th Montana Legislature

SENATE MEMBERS
JOHN "J.D." LYNCH
WALTER MCNUTT
FRED THOMAS
BILL WILSON

HOUSE MEMBERS
ERNEST BERGSAGEL
LARRY HAL GRINDE
JOE QUILICI
WILLIAM M. "BILL" RYAN

COMMITTEE STAFF
TODD EVERTS
LEG. ENVIRONMENTAL ANALYST
STEPHEN MALY
RESEARCHER

February 4, 1998

TO: Transition Advisory Committee Members

FR: Todd Everts, TAC Staff Attorney *OME*

RE: A Legal Analysis of the Electric Utility Industry Restructuring and Customer Choice Act's (UIRCCA) Reciprocity Provision

At the request of the TAC PSC Liaison Subcommittee, I have been asked to analyze the constitutionality of 69-8-411, MCA, better known as UIRCCA's reciprocity provision. In this analysis, the Subcommittee requested not only a legal analysis but also a review of UIRCCA's legislative history to document any legislative intent on the reciprocity issue.

Background: At the TAC October 1997 meeting, the Committee directed the TAC PSC Liaison Subcommittee to analyze and review the issue of reciprocity. The Subcommittee heard testimony from Avista Energy, PacifiCorp, Puget Sound Energy, and Washington Water Power that UIRCCA's reciprocity provision is having a chilling effect on competition in Montana and that the provision may be unconstitutional. Montana Power Company (MPC) testified that the reciprocity provision is a fairness and equity provision that applies company to company instead of state to state. MPC also viewed the provision as constitutional.

The Subcommittee decided to request a staff legal analysis of the reciprocity provision and to set up a panel discussion on the issue before the full TAC in February.

Issue: Is UIRCCA's reciprocity provision constitutional?

Short Answer: If interpreted as an interstate reciprocity provision, 69-8-411, MCA, could be subject to a legal challenge as constituting a burden on interstate commerce. A court would likely find that UIRCCA's reciprocity provision violates the commerce clause of the U.S. Constitution. If interpreted as intrastate (wholly within Montana) reciprocity, a court would likely find that the UIRCCA reciprocity provision is legally valid.

Legal Analysis:

1. Explanation of Montana's UIRCCA Reciprocity Provision

The term "reciprocity" is defined in the dictionary as "mutual dependence, action, or influence or a mutual exchange of privileges". In plain language, "reciprocity" basically means I get what you get and you get what I get and what we both get is usually mutually equal.

Section 69-8-411, MCA, provides:

Reciprocity. (1) Except as provided in 69-8-311, all electricity suppliers must be afforded open, fair, and nondiscriminatory access to customers and a comparable opportunity to compete.

(2) A distribution services provider or the distribution services provider's affiliates may not use another distribution services provider's facilities in the state of Montana to sell electricity to customers in the state of Montana unless the first distribution services provider or the distribution services provider's affiliates offer comparable and nondiscriminatory access to the distribution services provider's distribution facilities.

This provision requires, for example, that before Mr. Kilowatt (who controls the pole and lines either in or out of the State of Montana) can sell electricity to customers in Montana, Mr. Kilowatt must offer the same type of open access to his poles and lines that a Montana distribution services provider must offer under UIRCCA. Mr. Kilowatt may be barred from selling and delivering electricity in Montana until Mr. Kilowatt's state (or cooperative, if in Montana) permits retail direct access to Mr. Kilowatt's poles and lines.

UIRCCA provides for phased in customer choice of energy suppliers under 69-8-201, MCA. By definition, "choice" means that a customer's selection process includes more than one energy supplier. To ensure equal and competitive energy supply access to Montana customers, UIRCCA obligates a public utility distribution services provider (a public utility that controls the poles and lines) to "make distribution facilities available to all electricity suppliers, transmission service providers, and customers on a nondiscriminatory and comparable basis" (69-8-208(1)(a), MCA, emphasis added). This nondiscriminatory and comparable access also includes transmission services (69-8-209, MCA).

2. Explanation of U.S. Constitution's Commerce Clause.

The issue presented in the TAC PSC Liaison Subcommittee is whether UIRCCA's reciprocity provision if interpreted as interstate reciprocity violates Article I, section 8, clause 3, of the U.S. Constitution, which provides that "Congress shall have Power . . . [t]o regulate Commerce . . . among the several States". The commerce clause itself, even without congressional implementation, is a limitation on state power to regulate commerce. Sporhase v. Nebraska, 458

U.S. 941 (1982). The very purpose of the commerce clause was to create an area of free trade among the several states. Great Atlantic and Pacific Tea Co., Inc. v. Cottrell, 424 U.S. 366 (1976). The negative aspect of the commerce clause prohibits economic protectionism -- "that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors". New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273 (1988).

In general, the U.S. Supreme Court has developed the following two-part legal test under the commerce clause:

1. Does the state statute directly regulate or discriminate against interstate commerce or does its effect favor in-state economic interests over out-of-state interests? If so, courts have generally struck down the statute without further inquiry. Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986).

2. If the state statute is neutral on its face, has only indirect or incidental effects on interstate commerce, and regulates even handedly, the courts will uphold the statute "unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits". Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). See also Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981), and Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983).

3. **Does the Montana UIRCCA Reciprocity Provision (if interpreted as an interstate provision) Violate the Commerce Clause?**

I. Does the state statute directly regulate or discriminate against interstate commerce or does its effect favor in-state economic interests over out-of-state interests?

(A) Does the Montana UIRCCA reciprocity provision directly regulate interstate commerce?

Extending the hypothetical example of Mr. Kilowatt, assume that he and his distribution services system reside in the State of Oregon. Oregon has not opened its distribution services system to direct retail access. The UIRCCA reciprocity provision attempts to reach out and force enactment in Oregon of a statute that would allow for direct retail access before Mr. Kilowatt would be allowed to conduct business in Montana. Montana's UIRCCA reciprocity provision "has the impermissible practical effect of controlling commercial activity wholly outside [Montana's borders]". Healy v. Beer Institute, 491 U.S. 324, 332 (1989). "[A] statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature." Healy, 491 U.S. at 336.

Montana "cannot use the threat of economic isolation as a weapon to force other states to enact

substantially similar legislation any more than [Montana] can impose a reciprocity agreement against a sister state". Hardage v. Atkins, 619 F2d 871 (10th Cir. 1980).

A court would likely find that the UIRCCA reciprocity provision directly regulates interstate commerce and would not need to analyze the issue further.

(B) Does the Montana UIRCCA reciprocity provision discriminate against interstate commerce?

The net effect of UIRCCA's reciprocity provision is that entities like Mr. Kilowatt who control or own the poles and lines but whose state has not allowed direct retail access may be barred from competing in the Montana market, while those entities that do not control or own poles and lines (i.e., power marketers) are free to compete under the deadlines established in UIRCCA. Mr. Kilowatt would be disadvantaged as compared to all other market participants that did not own or control distribution facilities outside Montana. Additionally, Montana distribution services providers would receive an economic advantage in not having to compete with Mr. Kilowatt for Montana customers even though UIRCCA itself requires a public utility distribution services provider to "make distribution facilities available to all electricity suppliers, transmission services providers, and customers on a nondiscriminatory and comparable basis" (69-8-208(1)(a), MCA). The UIRCCA reciprocity provision specifically favors in-state economic interests over the out-of-state interests of Mr. Kilowatt.

Again, a court would likely find that the UIRCCA reciprocity provision facially or in effect discriminates against the interstate commerce that Mr. Kilowatt has to offer and would not need to analyze the issue further.

II. Assuming that the UIRCCA reciprocity provision neither directly regulates nor discriminates against interstate commerce, the reciprocity provision would be upheld "unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits". Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

The putative local interest or benefits expressed in the testimony before the TAC PSC Liaison Subcommittee have been one of equity and fairness for Montana distribution services providers. Paraphrasing the testimony provided: Why should other (out-of-state) distribution services providers be able to compete in the Montana market when Montana companies are barred from using the other providers' poles and wires to sell electricity because the other providers' states have not enacted direct retail access legislation? Montana companies need to compete on a level playing field in order to survive and prosper. The reciprocity provision is designed to level the playing field across state lines. Indeed, it is the policy of the State of Montana that "the financial integrity of electrical utilities should be fostered" (69-8-102(3), MCA). Montana clearly has a legitimate putative local interest in fostering the stability of its electrical utility industry given the enormous economic, environmental, and tax benefits that the industry provides.

The question for a reviewing court is whether the burden that the UIRCCA reciprocity provision places on interstate commerce is clearly excessive in relation to Montana's local interests. Montana would need to show that given the discriminatory nature of the reciprocity provision noted above, there are not less intrusive options to foster the stability of its electrical utility industry. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 (1981).

Under UIRCCA, Montana chose to facilitate competition and require nondiscriminatory direct retail access to its customers. In enacting UIRCCA, the Legislature felt that competition was ultimately the best way to protect Montana consumers and enhance its electric utility industry (69-8-102(2) through (4), MCA).

On the other hand, the burden on Mr. Kilowatt has been demonstrated to be substantial (see above). It limits Mr. Kilowatt's ability to compete in the Montana market even though, ironically, the fundamental premise of UIRCCA competition is that the more Mr. Kilowatts there are to compete for Montana consumers, the lower electric rates will presumably be.

A court would likely find that the UIRCCA reciprocity provision imposes a substantial burden on interstate commerce that far outweighs the permissible benefits that Montana has a right to expect as an exclusive member of the United States.

(As a side note, the issue of whether inaction in terms of direct retail access on the part of a state like Oregon would ever constitute a violation of the interstate commerce clause is not addressed in this analysis. It is also important to note that under UIRCCA, Montana made a conscious choice, unlike some other states, to institute market competition.)

Other Legal Considerations: There are some additional legal issues that may have a bearing on the validity of the UIRCCA reciprocity provision.

1. An out-of-state public utility like Mr. Kilowatt could make the argument that the requirement of retail access reciprocity is unenforceable because all retail wheeling transactions are interstate transmission subject to the exclusive jurisdiction of the Federal Energy Regulatory Commission (FERC) under Order No. 888, FERC Stats. and Regs. P31,036, 770-1. See Barbara Jost, "*Leveling the Playing Field -- Can Retail Reciprocity Work?*", Trend and Insight Electricity, American Bar Association, 1997.
2. Having suggested that FERC may have preemption authority, there is no question that states have been afforded extensive power over retail public utility regulation. See Panhandle Eastern Pipe Line Co. v. Michigan PSC, 341 U.S. 329 (1951), and Arkansas Electric Cooperative Corp. v. Arkansas PSC, 461 U.S. 375, 383-389 (1983). Even with this authority, a court will still utilize the two-part commerce clause test to determine the validity of the state action.

Legislative History: A fundamental premise of statutory construction is that if a statute is clear on its face, a court will not look to legislative intent for guidance. Having said that, the legislative history of UIRCCA shows that the constitutional issues of reciprocity were raised on the record in the Senate Taxation Committee by PacifiCorp. Because of the limited record in the House, it is unclear as to whether the reciprocity issue was raised. The summary minute records indicate that the legislative committee members of both houses did not discuss the reciprocity issue.

Conclusion: The TAC PSC Liaison Subcommittee requested that staff conduct a legal analysis of the UIRCCA reciprocity provision and present the findings to the full Transition Advisory Committee. This memo has concluded that if interpreted as an interstate reciprocity provision, a court would likely find a violation of the commerce clause. However, a statutory provision is presumed constitutional until a court finds otherwise. If the provision is interpreted as an intrastate reciprocity provision, its legal validity would likely be upheld.

As a legislative body, the TAC has several options. It may make prospective recommendations to the 1999 Legislature regarding the reciprocity provision to either modify, repeal, or leave the provision intact. The issue of reciprocity is a policy decision that obviously has legal implications. The TAC is an appropriate forum to wrestle with these policy issues.

APPENDIX 4



Electrical Industry Restructuring & Montana Power Company's Sale of Generation Assets

*A description of the implementation process to date and some issue-related talking points for the Transition
Advisory Committee meeting on March 13, 1998.*

Stephen Maly, Staff Research Analyst

Process/Procedural Highlights

- ▶ Senate Bill 390 established the TAC and assigned it the task of analyzing and reporting on the transition to effective competition. This monitoring process includes scheduled meetings and quarterly reports. The TAC has subdivided itself into two subcommittees, one on Universal Systems Benefits and the other on Education, plus two working groups to serve as liaison between the full TAC and the Public Service Commission and the Revenue Oversight Committee, respectively. The full committee is composed of 8 legislators; 4 from each house and party. All legislative members voted in favor of SB 390. The TAC also includes 12 appointed members representing stakeholder constituencies in the restructured policy/commercial environment. The initial term for members expires 12/31/99. The TAC met on July 11, 1997, and again on Oct. 6-7. MPC's December announcement regarding its power generation sales precipitated 2 additional TAC meetings to date, this one and one on January 9, which was held in conjunction with the Consumer Counsel. The next meeting is set (at the moment) for April 24. Subsequent meetings are tentatively scheduled for July 24, Sept. 18, October 23. SB 390 includes several other reporting and legislative recommendation deadlines prior to the 1999 Legislative Session.
- ▶ The Public Service Commission is in the midst of reviewing transition plans required by SB 390. A schedule of proceedings leading up to the issue of a final order has been adjusted to accommodate the proposed generation sale but will still honor the July 1 statutory date for large industrial customers to obtain choice of electrical supplier(s). The PSC hearing on the sales issues commences April 28, and the Commission plans to issue its final order on June 1.
- ▶ The Revenue Oversight Committee is charged under SB 390 with the duty of studying the tax implications of restructuring. ROC discussed and heard presentations on this issue at its Nov. 21 and Jan. 30 meetings, and will address it again on April 3, the date of its next meeting. ROC staff are attempting to compare effective tax rates on investor-owned utilities as well as electrical coops across the West, to better ascertain Montana's competitive position as a net power exporter, and to help determine which if any property tax rates and classifications might need to be changed by the legislature to achieve certain policy goals, among them competitive neutrality and the avoidance of tax burden shifting from one class of consumer to another. In short, the charge is to figure out what, how, and how much to change the tax structure so that (most) things stay the same. In addition to property tax adjustments, the ROC is likely to consider the imposition of a kilowatt hour tax.
- ▶ The Interim Property Tax Committee has discussed the property tax impacts in general

terms, and members have acknowledged the disproportionately large effects on Rosebud and Cascade counties. The Committee does not plan to investigate further, given the ROC's responsibility to do so under SB 390, and the TAC's overarching oversight function.

- ▶ FERC relicensing is a long, drawn out procedure. As MPC representatives have pointed out on prior occasions, deliberations over Kerr Dam have been going on for over 15 years, and they have yet to be concluded. The more immediate focus is on the Missouri-Madison hydroelectric dams, which currently operate under an existing FERC license. MPC made application for renewal in 1992, and included in its proposal some modifications to the system to enhance power production. A Draft EIS was issued in September, 1997. February 23 was the deadline for public comment on the DEIS. A Final EIS probably won't be published for another 12-18 months--well after the sale of MPC's facilities. There will be a 60-day period following that future date for public comment. Whether the change in ownership of the Missouri-Madison dams will alter this schedule is unknown. (See issue summary below.)
- ▶ Local governments are looking into the possibility of bidding on some of the Missouri River dams. Helena and Great Falls have discussed a joint venture, including one that involves a partnership arrangement with Montana-based electrical cooperatives. The financial costs of participating in the bidding process could be high--from tens of thousands to hundreds of thousands of dollars. The prospect of state ownership of some or all of the generation facilities has also been raised, but only preliminary research has been completed. The state-ownership approach has been stymied to date by confidentiality requirements attached to as yet unreleased detailed MPC bid package, the failed effort to hold a special Legislative Session to delay the effective date of key provisions of SB 390, and the highly compressed time frame for decisive action by state officials.
- ▶ Eight states have passed restructuring legislation: New Hampshire, Maine, Rhode Island, Pennsylvania, Oklahoma, Montana, Nevada, and California. Most states in the western region are studying the implications of restructuring or analyzing different legislative proposals before going forward. Idaho and Utah have established interim study committees. Restructuring legislation has been temporarily shelved or defeated in Oregon, Washington, Wyoming, Colorado, New Mexico and Arizona. In California, the western "pioneer" of partial deregulation, all customers are supposed to obtain choice at the end of March.
- ▶ National restructuring legislation is pending. Members of the House of Representatives are advocating the creation of a Congressional Electricity Caucus to try to attain a consensus on comprehensive legislation to give all consumers a choice of electricity providers. Several bills are under consideration, and will be taken up sometime in 1999. Most would mandate partial deregulation to allow customer choice and establish renewable energy incentives. There is marked reluctance to preempt states.

- ▶ Governor Racicot announced earlier this month that he plans to moderate a Town Meeting on restructuring issues on April 16, most likely here in the capitol.
- ▶ The TAC's next scheduled meeting is April 24. Members may decide to change that date in light of what is learned today, the outcome of the Governor's Town Meeting, and the PSC's proceedings.

Issue Summary

Electricity Prices: Are they going up or down? A Department of Energy study in 1997 forecast an increase in the coming years. Other analysts have reached similar conclusions, which are congruent with common intuition that points toward a leveling out of regional prices once regulatory barriers are removed. Many citizens from low-cost states fear that competition will raise their rates because relatively high-cost, high demand states will outbid local consumers. However, a number of regional economists criticized the DOE study for relying on erroneous assumptions. It is important to keep in mind what actually determines prices in a regional, deregulated market. Competition tends to push prices down so that they reflect marginal costs, which means the additional cost of adding another kilowatt of generation capacity. According to a recent Brookings Institution analysis, the marginal cost of production from existing steam-powered facilities is 1.7 cents/kwh, which reflects primarily coal and natural gas fuel costs. The associated transmission and distribution (T&D) costs average about .9 cents/kwh, suggesting that off-peak prices could be as low as 2.5 cents/kwh. Most new generation will be gas-fired combustion turbines, which turn out power at 3 cents/kw. With added T&D charges, the average long-run competitive price would be capped at 3.9 cents/kwh. (The average cost of residential electric power in Montana in 1996 was 6.3 cents/kwh.) However, there are other important factors to consider. Montana's situation is complicated by non-regulatory obstructions or hurdles, such as the state's geographic location, its current and potential market size, the carrying capacity and other technical characteristics of the transmission and distribution system serving the western grid, and the as-yet undefined structural and functional characteristics of a regional electricity exchange (an independent system operator) to effectively schedule and otherwise manage electron traffic and deal with power imbalances and "congestion" pricing.

Stranded costs: Stranded cost recovery has been a sort of "bottom line" for electric utilities since the restructuring debate began. The FERC and many state officials have conceded that electricity consumers must bear much if not all of the burden of power plants, supply contracts, and related infrastructure invested in under regulation and rendered uncompetitive by partial deregulation. In stark contrast, The American Local Power Project and other critics of restructuring believe that utility stockholders should be responsible for uneconomic investments. The measurement and valuation of stranded costs are contentious. For example, Montana Power Company's calculation of its stranded costs has been challenged by a number of intervenors in the Public Service Commission's transition plan filing process. The sale price of MPC's generation assets will determine, to a large degree, what if any stranded costs remain; the PSC will ultimately decide how such costs will be allocated to Montana consumers.

FERC Relicensing: As mentioned above, the process for issuing a new license for the Missouri-Madison Hydroelectric Project (FERC No. 2188) is underway. FERC licenses set conditions for land use within hydro project boundaries. These and other conditions and requirements can be amended at any time during the term of a license. The procedure calls for the licensee to request and justify a change. Following a detailed review process, the agency considers the proposed modification(s) and renders a decision. All of this takes place within the parameters of federal laws that require FERC to give equal consideration to power generation benefits and to environmental quality and the protection of fish and wildlife. The draft Environmental Impact Statement (DEIS) issued last fall recommends certain measures to mitigate the environmental pressures caused by MPCs proposed system alterations to increase total output. The DEIS does not address any change in ownership of the dams. (Citizens for Missouri Green Belt in Great Falls were unsuccessful in their attempt to obtain a 6-month extension period for public comment, basing this request on the fact that at the time the public hearing on the DEIS was held, the sale of the dams was not openly contemplated or discussed.) Whether the timing of the sale and the subsequent issuance of the Final EIS raises opportunities for either the new owner(s) or local combatants to alter the conditions of the license is, for the moment, unknown. FERC has dealt with ownership change and concomitant license transfers on other occasions in other states, but not in the midst of a relicensing process and not within a political environment where deregulation of retail sales is the dominant motif. Further ambiguity results from the unavailability of an easily interpreted and comprehensive map of all of the relevant project boundaries, including the acreage distribution of private and public lands within each.

Water Rights: MPC has, over the years, acquired a substantial number of senior water rights. To date, MPC's rights on the Missouri-Madison system have not been adjudicated by the state water court. However, the company has allowed junior water right holders--including irrigators--to use MPC water without charge or interference. Nearly a million acres of irrigated land upstream of Morony Dam is supplied in this manner. New owners of the generation facilities could decide to discontinue this practice and exercise a "call" on junior rights, in order to maximize the economic benefits of stepped-up hydroelectric production. A number of Montana citizens have advocated that FERC require the purchaser(s) of MPC facilities to subordinate their "inherited" senior rights to other water users. In the past, the Montana Dept. of Environmental Quality has taken the position that water rights in Montana are a state issue, not a federal issue, and that resolution of this matter should not be attained through a federal licensing process. However, more recently, the administration has asked FERC to analyze the water rights issues raised by the impending license transfer.

Fish, Wildlife, and other Recreation Resources: The major concerns are effective maintenance of healthy fish and wildlife habitat and the continuation of public access to streams and shorelines appurtenant to hydroelectric facilities. There is a trade-off between the value of recreational uses of such property and the benefits of power generation. As mentioned above, FERC licenses require a balance. As an article from a relevant license document reads: "So far as is consistent with proper operation of the project, the Licensee shall allow the public free access, to a reasonable extent, to project waters and adjacent project lands owned by the Licensee for the purpose of full public utilization of such lands and waters for navigation and for outdoor recreational purposes, including fishing and hunting." This seems straightforward on its face, but

there may be a considerable fudge factor in the first phrase, as "proper operation" of an enhanced power production facility may justify more restricted access. The same flexibility of interpretation might also apply to the terms "to a reasonable extent".

Jobs & Related Employment Concerns: The sale of MPCs generation facilities raises the specter of several hundred job losses. This concern is predicated in part on the possibility that the new owner(s) will replace current operations and maintenance personnel with different workers, perhaps brought into Montana from another state. Another possible outcome with similarly undesirable outcomes is the achievement of technical efficiencies that reduce the need for workers altogether. In other words, to maximize the profitability of the hydro facilities well-trained and relatively well-paid labor might be replaced with productive, reliable, and relatively low cost technology. In addition, a multiple owner scenario could complicate labor contracts. More generally, absentee owners and managers may have different attitudes and corporate philosophies than those of MPC; there is always potential for conflict when the work force is local and the top management is not.

Tax Revenue: The Department of Revenue has estimated that the total loss of property tax revenue caused by the shift from central to local assessment of generation facilities is somewhere near \$7 million. Rosebud County and Cascade County stand to lose the most. The statutory tie to other centrally assessed property (railroads and airlines, for example) complicates the task of compensating for these losses by a change in property tax rates and classifications. In addition, the nexus issue continues to confound efforts to speculate on the merits of replacing or supplementing property taxes with other types that could be levied on out-of-state suppliers and power marketers. While the ROC has a statutory obligation to assess the implications of restructuring, there is mounting concern that addressing these issues by themselves, irrespective of more general tax reform considerations, will be both difficult and dissatisfying. TAC's legislative members may want to contribute energy and attention to tax issues sooner rather than later, with the hope of lending some creative ideas to the Revenue Oversight Committee's reconstructive labors.



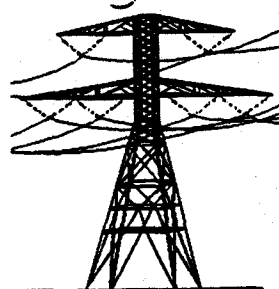
APPENDIX 5



T. A. C. REPORT

A Quarterly Newsletter of the Transition Advisory Committee
on Electrical Industry Restructuring

November 1997



Legislature Restructures Montana's Electrical Industry

In response to federal laws deregulating the wholesale electricity market and to a sweeping national movement to restructure the \$300 billion per year electric utility industry, the 1997 Montana Legislature decided to chart its own course in shaping Montana's restructuring destiny. The 1997 Legislature enacted and the Governor signed Senate Bill 390 to *partially* deregulate retail electricity sales. SB 390 is a very complex piece of legislation. Several key elements are summarized below:

Customer Choice: Large consumers of electricity who currently receive their electricity from Montana Power Company (MPC) or PacifiCorp will be able to choose their electricity supplier by July 1, 1998. As soon as it is administratively feasible, all remaining Montana consumers who currently

receive their electricity from MPC or PacifiCorp will have the ability to choose their electricity suppliers on or before July 1, 2002 but no later than July 1, 2004. Cooperative utilities have the ability to opt in or out of competition. Montana Dakota Utility can defer choice for its customers until July 1, 2006.

Cost of Electricity: The cost of electricity will no longer be regulated by the Public Service Commission (PSC). Electric service providers licensed by the PSC will compete for your business. The cost of electricity will be based on the competitive market price and the transition costs associated with allowing your current electricity provider to move into a competitive market. Senate Bill 390 requires that those utilities that enter into competition establish a two year rate moratorium beginning

July 1, 1998 for all customers. An additional two year rate moratorium (with some exceptions) will be extended to small commercial and residential customers.

Funding for Low Income Energy Assistance, Energy Conservation, and Renewables:

SB 390 establishes a universal system benefits program (USBP) that will fund low income energy assistance programs, energy conservation and renewable energy projects. The contributions to the USBP are based on 2.4% of each utility's 1995 retail sales revenue. The 1997 Legislature gave the USBP fund a four year life span beginning July 1, 1999 and ending July 1, 2003.

If you would like a copy of Senate Bill 390 or more detailed information, please contact the Legislation Services Division at (406) 444-3064.



We are the Transition Advisory Committee and We Will Leave the Lights on for You

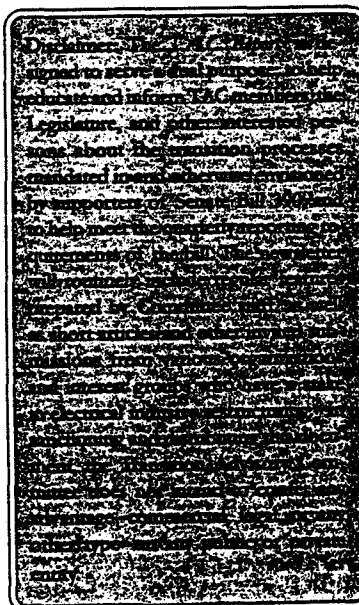
Eighteen members strong and incandescent with energy to face the task at hand, the Transition Advisory Committee (TAC) prepares to spend manifold kilowatt hours working toward shining the light on rewiring Montana's electrical industry. Despite the potential for some high voltage discussions, members vow to remain grounded in their efforts to ease the transition, foster competition, and keep citizens plugged in to the process.

TAC was created by Senate Bill 390. It is composed of 8 voting members who are Montana state legislators -- four from each house. The voting membership is bipartisan. Additionally, there are 12 nonvoting advisory representatives that embody a cross section of parties interested in the electric restructuring process.

The purpose of TAC is to:

- 1) Allow Montana citizens access to their representatives in overseeing Senate Bill 390 implementation.
- 2) Keep Montanans informed of electric industry restructuring events that are taking place.
- 3) Analyze and report on the transition to effective competition in the electricity supply market.
- 4) Recommend legislation if necessary to promote electric utility restructuring and retail choice of electricity suppliers.
- 5) Monitor and evaluate the universal system benefits program and make recommendations to the governor regarding implementation.

TAC is looking for your participation in the implementation of Senate Bill 390. For more information on Committee activities or to be put on the mailing list, call the Legislative Services Division at (406)444-3064.



ELECTRIC UTILITY
INDUSTRY RESTRUCTURING
TRANSITION ADVISORY COMMITTEE
Room 138, State Capitol
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

SENATE MEMBERS
Fred Thomas, Chairman
Mike Foster
John "J.D." Lynch
Bill Wilson

HOUSE MEMBERS
Bill Ryan, Vice-Chair
Ernest Bergsagel
Larry Hal Grinde
Joe Quilici

APPOINTED MEMBERS
Bob Anderson
Public Service Commission

Stephen Bradley
Crow Indian Tribe

Perry Cole
Montana Power Company

Al Davis
Dept. of Environmental Quality

Stan Dupree
IBEW-Local 44

Kathy Hadley
National Center for
Appropriate Technology

Judi Johansen
Avista Energy

Gene Leuwer
Rocky Mountain
Development Council

Bob Nelson
MT Consumer Counsel

Don Quander
Holland and Hart

Roma Taylor
Citizen's Advocate

Dave Wheelihan
MT Electric Coop. Assn.

COMMITTEE STAFF
Todd Everts
Leg. Environmental Analyst

Stephen Maly
Research Analyst

The following persons contributed time and effort to this newsletter: John Hines, Northwest Power Planning Council; Nancy McLane, DEQ; Leanne Kurtz, Research Analyst; and Judy Keintz, contract secretary and general editor.

A Message from the Chairman. . .

It is my pleasure to report to you that all is going well in our Transition Advisory Committee and in the world of electrical restructuring. By the time you read this our Committee will have met twice and had subcommittee meetings as well.

Following the basic purpose of SB 390, which is to protect Montana's electrical rate paying customers, our Committee will endeavor to further educate ourselves in this area, follow the developments in this industry, and do our best to keep you up to date. Quite frankly, this is a big task. Here are a few of the major items. Rural Electrical Cooperatives: How have they reacted and where are they headed? Taxation: working with the Revenue Oversight Committee on possible tax impacts for

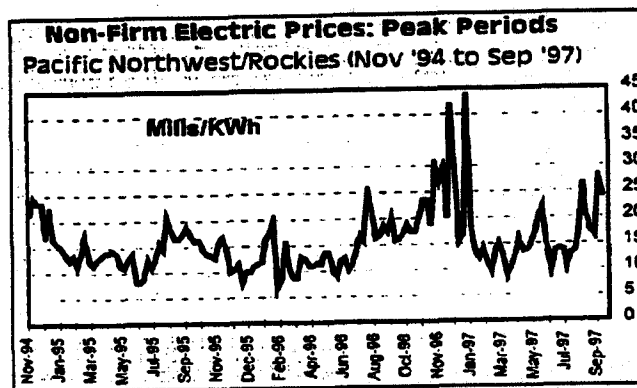
state and local government. Pilot Projects: When, Where, & How? A great deal rests on these pilot projects. They may be the greatest way to educate Montanans on the future. Time frame: Are some of our schedules in SB 390 too long? Should they be shortened? There are more, but these are some of the issues this Committee will work on.

I am surprised at the interest around the country in our SB 390. Several committee members have visited and spoken around the country about what we accomplished in SB 390. I believe this speaks well for us here in Montana.

Well, there is a lot of work to do and I ask you to inquire and stay tuned.

Fred Thomas, Chairman

The Price of Power



Source: Clearing Up, NewsData Corporation, September 15, 1997, No. 793.

Glossary

The language of restructuring is arcane and replete with technical terms. The electrical power industry has its own language, to which has been added generous doses of jargon by state and federal regulatory agencies. Moreover, the dialogue among competing interests in the gas and electric arena is flavored with meaningful nuances that are largely unintelligible to the uninitiated. With all that in mind, this and future issues of the T.A.C. Report will feature a glossary section that is intended to increase general familiarity with key terms and phrases.

Electrical Industry Restructuring: The electrical power industry historically has been composed primarily of investor-owned utilities. These utility companies have been predominantly vertically integrated monopolies (combining electricity generation, transmission, and distribution), whose prices have been regulated by State and Federal government agencies. Restructuring the industry entails the introduction of competition into at least the generation phase of electricity production, with a corresponding decrease in regulatory control. Restructuring may also modify or eliminate other traditional aspects of investor-owned utilities, including their exclusive franchise to serve a given geographical area, assured rates of return, and vertical integration of the production process.

Universal System Benefits Charges (USBCs): Universal services refers to services regarded as sufficient for basic needs and must be provided to all members of the population regardless of income. Under SB 390, USBCs means public purpose programs for: cost-effective energy conservation, renewable resource projects and applications, low-income customer weatherization, renewable resource projects and applications, research and development programs related to conservation and renewables, market transformation designed to encourage competitive markets for public purpose programs, and low-income energy assistance.

UPDATES

Public Service Commission



PacifiCorp and Montana Power Company (MPC) each filed Transition Plans on July 1, 1997, as required by Senate Bill 390. The PSC issued Preliminary Determinations on both companies' Transition Plans, finding each deficient in meeting the requirements of SB 390. MPC supplemented its filing on August 26, and PacifiCorp's Revised Plan is due October 16. The formal hearing on MPC's package is scheduled to begin on February 24, 1998, with a final order due May 1, 1998. The PSC will conduct PacifiCorp's hearing beginning March 24, 1998, and its final order is due June 1.

Denise Peterson, PSC, 406-444-6377 (<http://www.psc.mt.gov>)

Montana Cooperatives

The Montana Electric Cooperatives Association (MECA) formed a Restructuring Task Force in the spring of 1997. The Task Force is helping MECA's 25-member cooperatives and, in turn, their individual members, understand the ramifications of SB 390. It is also helping the organization to define ways to best comply with the legislation.

The Task Force formed several working groups to deal with specific aspects of the law. The most immediate need was to educate members about just what was and was not required by the legislation. The cooperatives and their members need to decide whether they want to participate in restructuring or not, since SB 390 allows them to make a choice. Then, should they decide in the affirmative, everyone concerned needs to know how to make informed decisions about power suppliers and related services options.

Over 80,000 pamphlets explaining SB 390 were sent to MECA members and their constituents. Press releases, media interviews, panel discussions and community group presentations are being made in addition to the extensive information that is featured in cooperatives' newsletters and *Rural Montana* magazine.

Other Task Force working groups are developing generic transition plans and defining uniform approaches to Universal System Benefits Charges (USBC) requirements and territorial integrity agreements. While each cooperative will make its own decisions and will implement them accordingly, MECA is working to create suggested uniform guidelines for complying with the various aspects of SB 390. MECA's goal is to facilitate the transition into the new competitive era with as much understanding and as little difficulty as possible.

Mack McConnell, MECA, 406-751-8333

The Road to Customer Choice

With the enactment of Senate Bill 390, the Montana Legislature provided the structure and framework for electric utility customers in the state of Montana to have the opportunity to choose an electric power supplier. The Act establishes requirements for investor owned utilities, rural electric cooperatives, the Montana Public Service Commission (the PSC), electricity suppliers, and others to follow to ensure an orderly and timely process that allows customer choice of power suppliers. There are numerous safeguards and consumer protection provisions in the Act as well, including oversight by the Transition Advisory Committee (TAC).

The investor owned public utilities in the state appointed Perry Cole, Vice President, Business Development and Regulatory Affairs for the Montana Power Company (MPC) the joint representative of MPC, PacifiCorp and Montana-Dakota Utilities to the TAC. These three utilities have also committed to donate a total of \$165,800 toward the \$200,000 budgeted for the operations of the TAC during the interim. The donations are based upon prorata shares of each utility equal to their 1995 energy sales in Montana compared to the total 1995 retail energy sales in Montana.

Consistent with the requirements of the Act, MPC's Transition Plan provides for phased-in choice allowing all customers to choose their electricity supplier within a four-year transition period beginning July 1, 1998. The filing provides for competitive prices and choices for customers, safe and reliable service, promotion and payment of public purpose programs, transition cost recovery, pilot programs beginning in 1998 for residential and commercial customers, and customer education. Larger commercial customers will have the opportunity to choose an electric supplier by July 1, 1998.

The proceeding before the PSC is a contested case following the Montana Administrative Procedure Act. Hearings on MPC's Transition Plan are expected to begin in February 1998, with a final order and decision by the PSC in May 1998. The filing has attracted numerous intervenors. The plan addresses significant issues and concerns, including the level of recovery of MPC's competitive transition costs which already are in rates, consumer protection, the utility's organizational structure and functional separation, universal system benefit programs which provide energy and bill assistance, conservation and weatherization to low income customers, pilot programs to test and improve administrative functions related to choice, and customer education plans.

Perry Cole, MPC, 406-497-3247 (<http://www.mtpower.com>)

Pilot Lights

While large industrial and commercial consumers of electrical energy will be able to choose their supply source beginning on July 1, 1998, most small commercial and residential purchasers will have to wait through a multi-year phase-in period. In the interval between passage of Senate Bill 390 and the anticipated closure of the transition period in 2002, a variety of technical activities such as load profiling and related statistical analyses will necessarily precede uninhibited customer choice. At the same time, Montana Power Company, PacifiCorp, and participating electrical cooperatives will be undertaking pilot projects to determine what types of billing, cost, and service structures will work best in a competitive market environment. Under the provisions of SB 390, the deadline for selecting pilots for implementation is July 1, 1998. It is too early to tell which communities or other clusters of consumers will be included in either MPC or PacifiCorp programs. So, in lieu of any detailed descriptions of existing pilots in Montana, a process and a proposal are briefly summarized below.

The Collaborative. Montana Power Company has established a collaborative effort to develop agreement among various interested parties in support of education and pilot programs. MPC has invited other electric power distributors, the Public Service Commission, the Consumer Counsel, the Department of Environmental Quality, low-income advocates and others to work together toward this twin goal. The Collaborative will operate by consensus, and Gerald Mueller has been selected to facilitate the meetings.

The first meeting of "the Collaborative" was held on September 23 in Helena, and approximately 30 persons representing diverse agencies and constituencies participated. Basic ground rules and a work plan were considered, along with the desirability of expanding participation in order to ensure that all key interest groups are fairly represented in the process and its results. A subsequent meeting was held on October 16. After fine-tuning a statement of goals and purposes, the participants discussed the basic elements of a consistent educational message about restructuring for a statewide audience of primarily small commercial and residential customers.

The next meeting is scheduled for November 5th, also in Helena. The general plan is to hold Collaborative meetings every 2 weeks for the balance of 1997, and to continue the process on a less frequent basis in 1998, as projects are implemented. For further information, and to place yourself on the mailing list for announcements of meeting dates, times, and places, contact Deb Young at MPC, 406-497-2339, or debyoung@mtpower.com.

MACO as broker for local governments. On September 24 the Helena Citizens' Council sponsored a panel discussion at the City-County Building entitled "Exploring Options for Local Governments and Small Utility Customers in Montana". Gordon Morris, representing the Montana Association of Counties (MACO), outlined a proposal to include local governments in a "direct access" pilot program. The following summary contains abbreviated excerpts from Mr. Morris' remarks that evening.

Small customer aggregation is a necessity in the arena of retail energy competition. Citizen aggregation has two immediate benefits in this new competitive environment: it balances market power and provides a realistic and efficient means for making choice available to all customers, not just large ones...

"[B]uyers" must come together and shop jointly for the purchase of power. This can be done by creating customer aggregates or customer coops (consumercos). I propose a pilot based on the notion of a local government consumerco which could grow, in time, to include residential customers. This "local government consumerco" would be administered through MACO. All administrative services would be provided by the Association, which would act as the "broker", matching the end users in the group—local governments—with the best possible provider of electrical service...Distribution would not be considered in this proposal, as that function would best be contracted out to ensure reliable service and maintenance. Metering, billing (and collection), customer service, and other services related to the acquisition of electricity would be contracted for as part of the broker function.

Looking Ahead



November

Transition Advisory Committee:

Education Subcommittee Activities
contact Stephen Maly, 406-444-3064
Universal Systems Benefits
Subcommittee Meeting
contact Todd Everts, 406-444-3742

The Education/Pilot Program

Collaborative - Nov. 5th, PSC, Helena
contact Deb Young, MPC, 497-2339
or Gerald Mueller, 543-0026

Revenue Oversight Committee:

November 21, Room 104, State Capitol
contact Jeff Martin, Legislative
Services, 444-3064

December

1997 National Electricity Forum, Mayflower Hotel, Washington D.C., December 8-9, National Association of Regulatory Utility Commissioners (NARUC). Registration fee for government officials and consumer/environmental advocates, \$100. For details, call 202-898-2200 or send fax to 202-898-2213.

The Collaborative

(See November for contact persons)

February

Transition Advisory Committee Meeting

February 6, Holiday Inn, Missoula

Agenda topics will include:

- PSC licensing criteria for power marketers
- Customer aggregation strategies
- Update on Universal Systems Benefits Programs

contact Todd Everts or Stephen Maly
Legislative Services, 444-3064

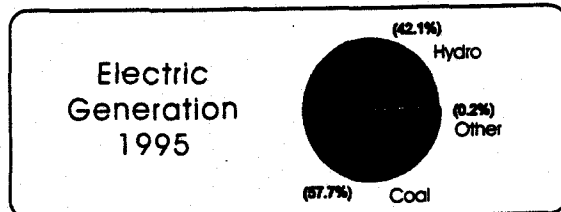
Electricity in Montana—an Overview

By: Alan Davis, Montana Department of Environmental Quality

Electricity is important to Montana. It affects nearly every aspect of our lives and every sector of our economy. In Montana it is a significant industry with a capital investment exceeding \$2 billion and annual revenues exceeding \$500 million.

Generation

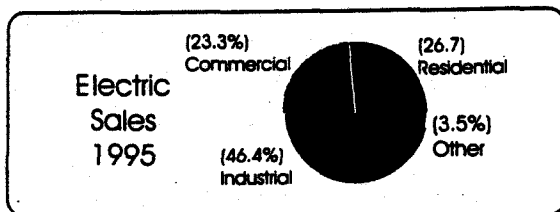
Montana has nameplate generation capacity of about 5000 Megawatts (MW), that is, all facilities running full out at all times. A MW is the about the amount of energy it takes to operate 1000 houses. The average generation, depending on loads and variations in the hydroelectric system, is about 2800 MW.



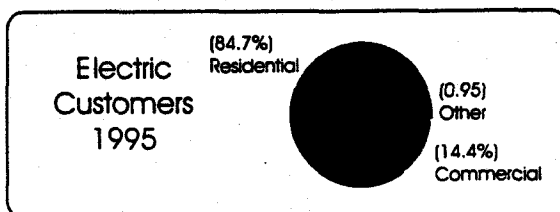
Generating capacity has increased about 2.5 times over the past 20 years. The addition of the Colstrip facilities changed Montana from a hydro-based system to one dominated by coal-fired generation. By contrast, generation in the Pacific Northwest is 16% coal and 62% hydro.

Consumption

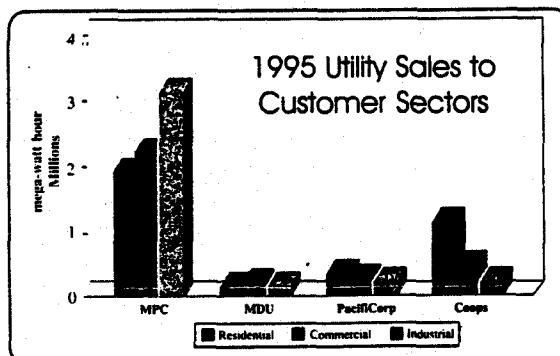
Utilities are characterized by when maximum or peak loads occur. Montana, as with the Northwest, has peak loads in the winter. Some individual cooperatives, PacifiCorp, and MDU peak in the summer. Most of the US is summer peaking. The main factor contributing to peak loads in Montana is heating and lighting houses in the winter.



Montana has significant industrial use of electricity, with nearly 50 percent of the sales going to the industrial sector. The residential and commercial sectors equally constitute the remaining sales.



The residential sector has 85 percent of the customers in the state. The commercial sector has 14 percent and the industrial sector is less than 1 percent of the customers. The indicator that Montana has a significant industrial sector is that less than 1 percent of the customers use nearly half of the electricity in the state.



The industrial sector is not spread equally among the utilities and cooperatives in the state. Excluding the Columbia Falls Aluminum Company facility, the industrial sector is significant only in Montana Power Company's current service territory. The cooperatives, MDU and PacifiCorp have only minimal amounts of industrial load in Montana.

Exports

Combining generation and consumption determines the export electricity sales. Montana on an average year exports around 40 percent of the electricity produced in the state. The amount varies with water conditions in the reservoirs and weather. In general, Montana is considered a low-cost producer of electricity.



Milestones in the Transition Process

1997

Senate Bill No. 390 is passed by the legislature and signed into law by the governor.
July 1 - MPC and PacifiCorp file transition plans with Public Service Commission
Aug. 26 - MPC files revised transition plan
Oct. 16 - PacifiCorp files revised transition plan

1998

May 1 - PSC issues final order on MPC transition plan
June 1 - PSC issues final order on PacifiCorp transition plan
July 1 - Rate moratorium takes effect; pilot programs launch
Nov. 1 - TAC makes recommendations to legislature and governor regarding assistance funding levels
Before Dec. 31 - Implementation of Universal Systems Benefits Charges (USBCs)

1999

Jan. 1 - 56th Montana Legislature opens for 90-day session

2000

Before July 1 - MPC and PacifiCorp report results of pilot programs to PSC and TAC

2002

End of transition period: all customers may exercise choice. Contingent on PSC findings re: market conditions

2004

End of transition period extension (if applicable)

2006

Deadline for Montana Dakota Utilities to provide customer choice

BiblioWeb Notes:

Selected sources of information pertinent to electrical industry restructuring and closely-related topics.

1. Publications

Retail Pilot Programs: The First Six, Edison Electric Institute, 1997. This 96-page report prepared by the Edison Electric Institute describes six of the initial retail access pilot programs, whereby participating customers are currently receiving electricity from suppliers other than their traditional incumbent source. The report costs \$50 for EEI members, \$100 for non-members. To obtain a copy, call 1-800-525-5562 or write EEI, Box 2800, Kearneysville, West Virginia 25430.

A Comparison of Selected Electric Restructuring Legislation, August, 1997. This is a 25-page comparison of the restructuring bills from eight states: New Hampshire, Rhode Island, California, Pennsylvania, Oklahoma, Maine, Nevada, and Montana. Prepared by Scott Yount, Research Division, Nevada Legislative Council, 702-687-6825.

Restructuring Energy Industries: Lessons from Natural Gas, Energy Information Administration, 1997. This study analyzes changes, and results (including costs and consumer in industry restructuring in order to develop selective restructuring of the electric power industry. Contact EIA Office of Oil and Gas, 202-586-6408.

2. Web sites

■ Energy Online's daily news summaries cover the electric industry, and focus on restructuring issues. <http://www.energyonline.com>

■ The LEAP Letter is a bimonthly overview of state and federal actions on restructuring, covering such topics as: state legislation, regulatory actions, court cases and commission findings, emerging issues, and market trends. <http://www.spratley.com>

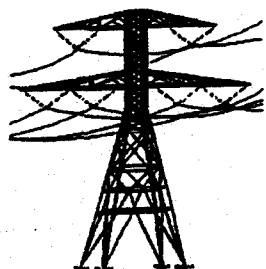
■ The National Association of Regulatory Utility Commissioners (NARUC) has teamed up with the National Conference of State Legislatures (NCSL) to provide timely, high-quality information about restructuring across the country. <http://www.erols.com/naruc/nccel.htm>

■ The U.S. Department of Energy's Energy Information Administration (EIA) supplies a wealth of information, including press releases, study reports, and other documents of interest. <http://www.eia.doe.gov>

Five hundred copies of this public document were published at an estimated cost of \$1.11 per copy for a total cost of \$556.00.

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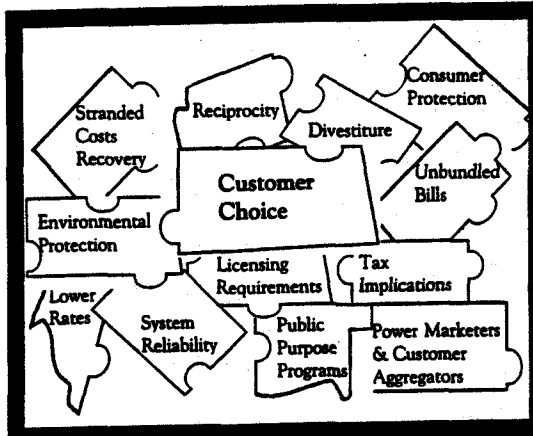
A Quarterly Newsletter of the Transition Advisory Committee on Electrical Industry Restructuring

February 1998

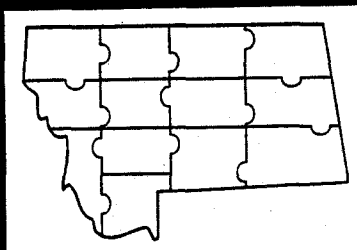


The Electric Puzzle

Electrical industry restructuring is a complex puzzle. Getting an accurate sense of the whole requires the piecing together of seemingly disparate and technically sophisticated components. Moreover, each piece of the puzzle is another puzzle unto itself, complete with hard to decipher jargon and elusive logic. None of these issue-laden modules is entirely separate from any other; in many cases, it's difficult to tell where one stops and another begins. After all, electricity is all about interconnectedness. In such a multidimensional context, it would not be surprising if most Montana citizens are a bit confused about what restructuring promises or portends for them as residential or small business consumers of electricity. Within the Transition Advisory Committee itself, a group that consists of industry and consumer group representatives as well as legislators who are committed to seeing the process through, there is an inescapable (albeit congenial) tension arising from distinctly different interests and perspectives. Like the public at large, the TAC staff feels, at times, somewhat stranded, out of the loop, genuinely perplexed. (We trust that none of our readers--or the Committee members--will find this admission shocking.)



MONTANA



Where the pieces are coming together.

The ambiguity surrounding the motives, decisions, and anticipated results in the restructuring process was captured by Senator Fred Thomas, the TAC Chairman, at the outset of a special joint meeting with the Consumer Counsel on January 9th to discuss the ramifications of Montana Power Company's surprise announcement on the sale of its generation assets: "The net outcome I'm looking for is to give us and the state of Montana a clear picture of what hopefully will happen." If nothing else, the TAC is demonstrating the worth of its statutory purposes by engaging its members in an effort to understand the puzzle piecemeal, through active subcommittees, as well as in a holistic fashion, and by inviting the public to join in the ongoing discussion.

As the accompanying diagram suggests (the graphic image was borrowed from a similar rendition of California), there are at least a baker's dozen of major pieces that need to be arranged correctly before the end result of restructuring can be well understood. MPC's decision to sell its generation added a big new piece—divestiture—and changed the shape of an even bigger one, stranded costs. The MPC's revised Transition Plan, filed with the PSC last August, includes testimony that reads as follows: "MPC has a corporate objective to remain in the generation business and it does not plan to sell its power-

supply assets...Generation asset sales would be very disruptive to employees, communities and local taxation and MPC would be a much smaller entity." It should be noted, however, that the drafters of SB 390 did at least contemplate divestiture, since a "competitive bid sale" is one of the allowable means of determining stranded costs. At the TAC/Consumer Counsel meeting in January, nobody asked MPC officials why the company changed its mind. It's possible that the turnaround was largely the consequence of widely divergent cost figures for the company's stranded costs. MPC's calculations, based on the future price method—one of 3 different methodologies permitted under SB 390—resulted in a stranded cost estimate of nearly \$800 million. Other groups, including large industrial firms and the Consumer Counsel, came to quite different conclusions, asserting that MPC had overstated costs by \$500 million or more. (An article in the Sept/Oct '97 issue of *Western Legislatures* states that Montana is one of several states undergoing electrical industry restructuring where the stranded costs of investor-owned utilities are actually negative.) The supposition seems to be that such a wide gap between MPC's figures and those submitted to the PSC by other interested parties could not be reconciled, and that costly, time-consuming litigation was looming on the near horizon.

(More page 4)

ELECTRIC UTILITY
INDUSTRY RESTRUCTURING
TRANSITION ADVISORY COMMITTEE
Room 138, State Capitol
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

SENATE MEMBERS
Fred Thomas, Chairman
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Todd Everts
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Committee Secretary and
General Editor

A Message from the Chairman. . .

Well, a lot has gone on since our last report. The proposed sale by Montana Power Company of their generation assets has substantially changed the complexion of the transition process and procedure, but the Public Service Commission says they can handle it!

The sale could reduce state property tax revenue by about \$3 million a year and local government revenues by an additional \$4 million a year. However, the sale could also generate a one-time

income tax windfall amounting to approximately \$20 million, thus offsetting these reduced property tax collections. We are focusing more and more on the sale impacts, but we also continue to work on the Universal Systems Benefits Programs, Customer Education, other tax issues, and the Public Service Commission's role under Senate Bill 390.

Please continue to stay tuned and give us your input.

Fred Thomas, Chairman

Glossary

Transition Costs (or Stranded Costs): The embedded costs of utility investments exceeding market prices. Such costs include purchases or investments made, or contracts entered into because of regulatory requirements, and with the understanding that regulatory agencies would allow utilities to recover such costs through rates charged to customers. SB 390 contains a lengthy and detailed definition of Transition costs [see 69-8-103 (22), MCA]. A simple example of stranded costs is the difference between the cost of building a power plant in the past, under regulation, and its real worth on the open market today

Aggregator: Generally, an entity that puts together (aggregates) customers into a buying group for the purchase of a commodity or service. Vertically integrated investor owned utilities and rural electric cooperatives perform this function in today's electrical power market. Other entities such as power marketers, brokers, associations or buyer cooperatives could perform this function in a restructured market. Under SB 390, an aggregator or "market aggregator" must be licensed by the Public Service Commission and takes ownership title to the power it purchases on behalf of a group. Aggregation refers either to the formation of a group of consumers for the purpose of bargaining for the lowest possible electricity rates, or the process of estimating demand and scheduling deliveries of power to a group of customer.

Power marketers: Agents for generation projects who promote and sell power on behalf of a generator of electrical power (such as a utility company). A marketer may also arrange transmission, distribution, or other ancillary services as well. Marketers perform many of the same functions as a broker, but a broker acts as an intermediary while a marketer represents itself or another power generator.

ContACTs:

Senator Fred Thomas is the TAC Chairman, 3566 Holly Lane, Stevensville, MT 59870-6634; (406) 777-5005.

The TAC Education Subcommittee Chairman is Dave Wheelihan, Exec. Director of the Montana Electric Cooperatives Association, Box 1306, Great Falls, MT 59403; (406) 761-8333. Other members are Bob Nelson, Roma Taylor, Alan Davis, and Stephen Bradley.

The Public Service Commission Liaison Group is chaired by Senator J.D. Lynch, 527 W. Mercury Street, Butte, MT 59701-1629; (406) 496-2150. Other members are Rep. Joe Quilici, Judi Johansen, Don Quander, and Stan Dupree.

The Universal Systems Benefits Programs (USBPs) Subcommittee Chairman is Rep. Ernest Bergsagel, HC 84, Box 8045, Malta, MT 59538-9701; (406) 658-2154. Other members are Don Quander, Kathy Hadley, Gene Leuwer, Perry Cole, and Bob Anderson.

The Taxation Liaison Group is chaired by Rep. Bill Ryan, 8 18th Ave. South, Great Falls, MT 59405-6634; (406) 761-8333. Other members are Bob Anderson, Perry Cole, and Sen. Walter McNutt.


UPDATES . . .



BPA: Federal Wholesale Power in the Northwest Region

The Bonneville Power Administration (BPA) is a federal agency that has provided electricity on primarily a wholesale basis to Northwest states for 60 years. BPA provides 50 percent of the power and 75 percent of the electrical transmission facilities in the Northwest region. The agency sells most of the power generated by federal hydroelectric dams at cost to various types of public utilities. BPA also provides other benefits to the region, including significant investments in fish and wildlife programs, energy efficiency, and renewable energy technologies. As a wholesaler, BPA currently serves over 20 percent of the electric load in Montana through rural coops and service to Columbia Falls Aluminum Co. BPA power reaches roughly 10 percent of Montana consumers, primarily rural, residential, and small commercial end-users. These percentages will increase in the year 2000 as a result of new contracts with central and eastern Montana coops.

Bonneville has a significant presence in the electrical power arena in Montana; what is less obvious to many observers is what role BPA will play in the transition to retail choice. In accordance with the Regional Review, a body convened in 1996 that included Governor Racicot and 3 other Northwest governors, BPA will continue to allocate power at cost primarily through a subscription process. Typical "subscribers" are coops and other types of public utilities and nonprofit aggregators who are willing to purchase federal power at cost for a period of 5 to 20 years. Power not sold on a subscription basis may be sold in various at market rates either inside or outside the region to other utilities and marketers. BPA will not, however, engage in direct competition with other suppliers for retail sales. Through partnerships with qualified retailers, BPA has a primary interest in continuing its historic role of conveying the benefits of the federal hydrosystem to rural and residential consumers.


 For further information, contact Gail Kuntz at (406) 449-5790 or visit BPA's website: <http://www.bpa.gov>

Large Customers, Small Customers, and Choice

On July 1, 1998, large customers of the Montana Power Company and of Pacific Power and Light Company (PacifiCorp) will be legally free to buy electricity from a supplier of their choice. This is an important first step for all Montana consumers. First, because these customers employ many Montanans and are vital to a healthy economy for us all. Second, because this opening will pave the way for new choices for all Montana electricity customers.

One important objective of the new customer choice law, SB 390, is to enable Montana businesses, large and small, to compete effectively. After wages and benefits, the cost of electricity is the biggest single operating cost for many Montana firms, and often for local and state government as well. Large customers are not only refineries, wood products facilities, cement plants, mines, and silicon chip manufacturers; they also include medical complexes, local and state government facilities, large wholesale and retail businesses, and the Montana University System. In fact, SB 390 begins with choice for all customers with an electric load of more than 1,000 kilowatts or that have multiple meters over 300 kilowatts that, when aggregated, amount to more than 1,000 kilowatts. A competitive market price for electricity is vital to keep these large customers competitive and to keep the costs of government facilities down.

But all customers deserve choices and access to market prices. The smallest businesses, and consumers in their homes, ought to have access to new services and better prices, and the opportunity to control their own energy budget. To accomplish this, SB 390 requires that representative pilot programs also begin on July 1, 1998, so that smaller customers can choose their supplier "as soon as administratively feasible." Large customers support choice for all Montanans because the larger the market in Montana, the more suppliers will compete for customers of all sizes. A robust, competitive electricity market in Montana is good for all of us. But just as important, it simply is fair that every customer should be free to choose.

 Don Quander represents large industrial power consumers on the TAC and is an attorney at Holland and Hart in Billings. He can be reached at (406) 252-2166.

Consumer Counsel an Active Voice in the Transition

The Montana Consumer Counsel (MCC) is participating in several restructuring activities, including the Montana Power Company (MPC) and PacifiCorp transition plan filings with the Public Service Commission (PSC). Intervenor testimony was filed in November in response to MPC's plan, and MCC's testimony addressed several issues.

A transition cost valuation was conducted using market price forecasts and embedded costs of MPC generation facilities. This valuation considered costs and revenues over the remaining lives of the assets. The results indicated that benefits associated with the hydro and thermal (coal-fired) facilities more than offset the stranded costs related to qualifying facilities (QFs) and regulatory assets. (Hydro-thermal, QF, and regulatory assets are the three categories of transition costs provided for in SB 390.)

MPC's announcement that it intends to sell its electricity generation assets changed the circumstances under consideration in the restructuring case before the PSC. MCC supported procedural schedule revisions that will allow the opportunity for results from such a sale to be used in place of market price valuations of transition costs. The new schedule anticipates that customer choice will begin to be implemented July 1 (as required by SB 390), but that transition cost issues will be revisited later this year, when information from the sale process is expected to be available. MPC filed a revised plan on January 30 that includes interim transition cost provisions.

 Bob Nelson represents the Consumer Counsel on the TAC and can be contacted at (406) 444-2771.

(Continued from page 1)

Montana Power Company's decision to sell all of its generation capacity effectively negates the largest component of the stranded cost controversy; the market will determine the real worth of the production facilities. Nevertheless, the altered contours of the stranded cost piece of the puzzle means that the TAC and others will need to address some unfamiliar issues. For example, if MPC manages to sell all of its facilities for a price that exceeds the \$600 million book value plus the company's transactions costs (such as legal and investment services fees, employee compensation packages, and its contract with Goldman Sachs), estimated at \$52 million, then the Public Service Commission will have to determine how the remaining proceeds will be distributed through rebates or rate reductions to MPC customers. In the likely scenario where the purchase MPC's generation assets has not been completed before July 1, 1998--the statutorily fixed date for large customer choice--the PSC will also be faced with the task of working out just what stranded costs (aka Competitive Transition Costs, or CTCs) will be part of customers' bills until the sale is completed in financial terms, which may not be for another year or so.

Implementation of Senate Bill 390 is proving to be complicated, as the members of the Transition Advisory Committee anticipated it would be. Montana Power Company's surprise announcement on December 9 that it is putting all of its electricity generating facilities on the auction block compelled changes in the Public Service Commission's procedures, precipitated a special joint meeting of the TAC and the Consumer Counsel, and generated new perspectives on restructuring among customers, competitors, and legislators. In addition, different interpretations of the sections of SB 390 concerning reciprocity, consumer education, pilot programs, and universal system benefits charges (USBCs) are stimulating renewed debate within the TAC and its most interested observers. Outside the TAC, a number of legislators have launched formal requests for information on the feasibility of the state entering into the bidding process for some of MPC's hydroelectric facilities and on whether the terms and conditions of pending federal license renewals on a number of dams would be adequate to protect public interests after the sale of generation plants to as-yet unknown buyers. On January 30, a bipartisan group of 18 state legislators called for a one-day special session in March to delay the effective date of SB 390 and thereby delay its implementation until after the 1999 regular session has concluded. As this issue of the TAC Report goes to print, it is uncertain whether a sufficient number of legislators (76) will vote in favor of a special session.

Meanwhile, related events outside Montana are also contributing to speculation about what the restructured landscape of electricity production and distribution in Montana will look like once the puzzle is pieced back together at the conclusion of the 4-year transition period. For example, California's restructuring legislation called for a January 1, 1998 starting date for large industrial customers. Complex computer glitches forced the state to delay customer choice until the end of March. In some areas of the country, the move toward partial deregulation is happening faster than expected, while in others, the pace is slowing. While the U.S. Congress is reportedly unlikely to act this year on any of the several pieces of proposed legislation that could, in effect, preempt much of what is going on at the state level (by speeding the timetable for choice, for example, or mandating greater investments in energy conservation), such federal action is likely, many observers agree, in 1999.

At present, the TAC is grappling with a plethora of open-ended questions, some relatively narrowly focused on this or that consumer group, others broadly encompassing everything affected by the economic and social intersections of water and power. Examples of both types include the following:

- ☐ How much and how soon will electricity prices for residential and small commercial consumers decrease or increase following the transition period? Will the sale of MPC's generation cause net tax losses or gains to the state?
- ☐ Who will buy the dams and generators and adjacent lands? What exactly will be included in the sale package? Will the new owners allow public access to private shorelines, and honor past practices regarding fish and wildlife? Which potential buyers will offer cheaper power to residential customers (85% of the total in Montana) and not just the large industrial customers (1%) that currently account for almost half the electricity consumed in the state?
- ☐ Will restructuring lead to any erosion of system reliability? Who will be responsible for scheduling and monitoring power sales into and out of Montana? Who will respond to (and be responsible for) delivery failures and storm-related blackouts?
- ☐ How important are geographic and demographic factors such as Montana's sparse population and relative isolation from densely populated urban centers in a restructured market for electricity? What role does relatively inexpensive power play in Montanans' quality of life, and in the state's potential for economic development?

The TAC has begun the process of putting the pieces of the restructuring puzzle together, and will continue to do so for the remainder of this year and through 1999.

Looking Ahead



MARCH

4-5 USBPs Subcommittee, State Capitol, Helena

5-6 Interim Property Tax Committee, Livingston

13 TAC meeting, State Capitol, Helena

24 Education Subcommittee, 10:00-Noon, State Capitol, Helena

APRIL

3 Revenue Oversight Committee, State Capitol, Helena

14-17 Western Interstate Energy Board and Western Regional Transmission Association joint meeting, Vancouver, B.C.
For Registration and Accommodations information, contact Doug Larson, WIEB, 303-573-8910.

24 TAC meeting (Helena, Great Falls or Butte)
Contact Todd Evers or Stephen Maly
Legislative Services - 444-3064

The Unbundled Bill. . .

Under regulation, the various components of utility bills have been "bundled" together rather than being itemized separately. For example, Montana Power Company customers currently receive monthly bills that do not distinguish power generation from transmission and distribution charges. The price per kilowatt hour of electricity or natural gas includes these costs, as well as others—including taxes—but ratepayers are presented with a bundled bottom line rather than a summation of discrete items. Under SB 390, this is going to change as of July 1, 1998. The legislation includes a provision requiring that power bills clearly show each item being charged to the customer. "Electrical bills must disclose but are not limited to the following: (a) distribution and transmission charges; (b) electricity supply charges; (c) competitive transition charges; and (d) universal systems benefits charges" (69-8-409, MCA). The Public Service Commission is responsible for issuing the implementing rules for unbundling, as well as for establishing the

procedures for discontinuing electrical service for customer nonpayment and reconnection. The PSC does not have similar authority with respect to electrical cooperatives.

State property taxes, which currently comprise about 9 percent of the total charges on your utility bill, are not part of the "unbundling" mandate.

The two figures below are hypothetical examples of unbundled bills provided by Montana Power and Big Flat Electric Cooperative in Malta. The MPC graphic shows the relative proportions of each charge in an unbundled bill. The Coop example goes a step farther by comparing the savings enjoyed by a relatively large customer to the net anticipated bottom-line increase for small-volume consumers. The graphic thus indicates how large volume purchases offsets fixed costs; this helps to illustrate, among other things, the logic of customer aggregation.

Big Flat Electric's Bill (Today)		Kwhrs:	1,000.00	10,000.00
Base Rate—\$11.00/mo.			11.00	11.00
Kwhr Charge—\$0.55 per Kwhr			55.00	550.00
Total Bill Today:			66.00	561.00
Big Flat Electric's Unbundled Bill		Kwhrs:	1,000.00	10,000.00
Electric Energy:	Energy—.03 per Kwhr		30.00	300.00
	Scheduling—.001 per Kwhr		1.00	10.00
	Voltage Support—.001 per Kwhr		1.00	10.00
	Stranded Cost—.003 per Kwhr		3.00	30.00
	Total Energy Charge:		35.00	350.00
Transmission:	Wheeling Charge: .005 per Kwhr			
	Total Transmission Charge:		5.00	50.00
Distribution:	Min Line Service		32.51	32.51
	Metering & Meter Reading—\$1.78/mo.		1.78	1.78
	Billing—\$1.22/mo.		1.22	1.22
	Information & Service —\$0.86/mo.		.86	.86
	Max Line —\$0.0114 per Kwhr		11.40	114.00
	Transmission Del—.0001 per Kwhr		.10	1.00
	Total Distribution Charge:		47.87	151.37
Total Bill (Unbundled):			87.87	551.37
Difference			\$21.87	(\$9.63)

Source: Big Flat Electric Cooperative



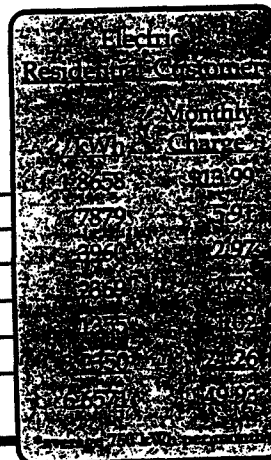
Restructuring Bill Impact on Customer Rates

Electric and Natural Gas Rate Freeze Provisions
Unbundling of Rate Components

Unbundled Rates

Commodity Charge at Market
CTC for Electric Gen. & Gas Production
CTC for OF's (electric only)
CTC for Regulatory Assets
Universal Systems Benefits Charge
Transmission/Distribution Charges

Current
Bundled
Rates



7/1/98

Time

7/1/02

Source: Montana Power Company





Milestones in the Transition Process

1997

Senate Bill 390 is passed by the legislature and signed into law by the Governor.

July 1—MPC and PacifiCorp file transition plans with the Public Service Commission.

Aug. 26—MPC files revised transition Plan

Oct. 16—PacifiCorp files revised transition plan

Dec. 9—MPC announces its intention to divest itself of all its generation assets

1998

Jan. 6—PSC unified schedule for MPC transition plan

March 24—PSC hearing on PacifiCorp revised transition plan commences

April 28—PSC hearing on MPC revised transition plan begins; will address first tier (pre-sale) issues only

June 1—PSC issues final order on PacifiCorp transition plan

June 24—PSC issues final order on MPC first tier issues

July 1—Rate moratorium enters into effect; pilot programs launch; large customers legally free to choose electricity suppliers

Nov. 1—TAC makes recommendations to legislature and governor re: energy assistance funding levels

Before Dec. 1—Implementation of Universal Systems Benefits Charges (USBCs)

1999

Jan. 1—56th Montana Legislature opens

2000

Before July 1—MPC and PacifiCorp report results of pilot programs to PSC and TAC

2002

End of transition period: all customers may exercise choice. Contingent on PSC findings re: market conditions.

BiblioWeb Notes

Selected sources of information pertinent to electrical industry restructuring and closely-related topics.

1. Publications

Electric Industry Restructuring: Why Shouldn't All Consumers Have a Choice? A report of the U.S. House of Representatives Energy and Power Subcommittee, April/May 1997, Serial No. 105-40, GPO stock #553-070-21554-9. Call House Doc. Rm at (202) 226-5200.

Competitive Change in the Electric Power Industry, U.S. Senate Energy and Natural Resources Committee, Aug., 1997, GPO Stock #552-070-21232-9. Mail order to Senate Doc. Rm., B-04 Hart Bldg., or call for information at (202) 224-7701.

2. Web Sites

<http://www.powermarketers.com> and <http://www.intr.net/pma> are two locations for power marketing organizations.

<http://www.enron.com> will get you to Enron corporation's home page and beyond.

<http://www.nreca.org/current> is the National Rural Electric Cooperatives Association home page.

Two firms have teamed up to offer a new site, <http://www.electricitychoice.com>, to provide information to consumers about electricity suppliers and will also highlight issues in the national debate on restructuring.

Disclaimer: The TAC Report is designed to help educate and inform TAC members, the Legislature, and other interested persons about the transition processes mandated in and otherwise envisioned by supporters of Senate Bill 390; and to help meet the quarterly reporting requirements of the bill. The newsletter will routinely include regular features prepared by Committee staff as well as short articles and other invited submissions from various organizations and interest groups. In sanctioning and distributing this document, the TAC does not intend to confer any advantage—commercial, legal, or any other type—on any public or private entity.

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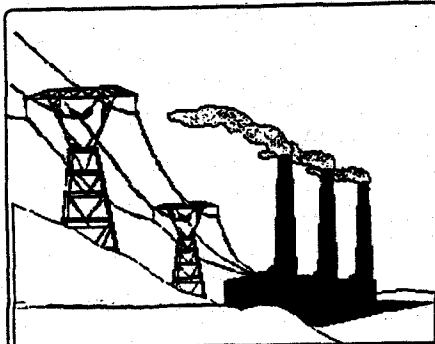
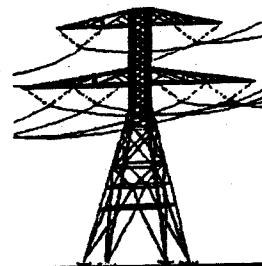
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T.A.C. REPORT

A Quarterly Newsletter of the
Transition Advisory Committee on
Electrical Industry Restructuring

August 1998



Some large power plants may become obsolete under restructuring.

The Historical Rationale for Regulated Monopolies

For much of the past century, electrical utilities fit economists' characterization of a "natural monopoly": high capital investment costs; a good or service with limited storability and transportability; and economies of scale, scope, and coordination that provide cost advantages to large, integrated systems. A single utility could produce and deliver power to diverse types of customers in a given area more efficiently than a multitude of competitors. The duplication of transmission and distribution wires was (and still is) considered wasteful and inefficient. States thus granted monopoly privileges to utilities in geographically defined service areas. In exchange for government-regulated prices and earnings, the utilities enjoyed statutory protection against competition. Regulation replaced competition to provide market discipline in those arenas where monopolies seemed "natural".

The legal justification for regulatory control of electrical power hinges on electricity's having become vital to the national economy as well as to citizens' creature comforts. The legitimacy of federal and state intervention is cemented in a number of U.S. and state supreme court decisions. Changing technology and other factors have eroded the economic arguments favoring monopolistic structures in the generation of electricity but have not yet undermined the logic of retaining regulatory regimes to ensure that the commodity remains available to everyone who needs it. As a U.S. Energy Information Agency booklet puts it,

The old school of thought that considered electric utility power generation, transmission, and distribution a "natural monopoly" has given way to a new school of thought. Today, there is a general consensus among legislators, regulators, industry analysts, and economists that the generation segment of power supply in today's environment would be more efficient and economical in a competitive market. In contrast, transmission and distribution will likely remain regulated and noncompetitive.

The Evolution of Power Structures . . .

By Stephen Maly, Research Analyst

Montana's electrical restructuring legislation did not emerge fresh and alone from a primordial ooze, nor did it arrive like a bolt from a big bang in the ozone layer. The analogy is far from exact, but it's fair to say that the electricity market in Montana, the U.S., and across North America is *evolving*, away from conditions of natural monopoly (see sidebar) where sole providers are best fitted to serve all customers, and toward some form of competition, where survival may be a hair less certain but should be less costly. The continent-wide transition toward choice in power supplier is not smooth, incremental, and continuous; it more closely resembles the punctuated equilibrium model of evolution that has been endorsed of late by biologists and other scientists. Once in awhile, the seemingly steady flow of the status quo is interrupted by one or more significant changes in the environment. Thereafter, things change with surprising rapidity, until a new normality takes shape and becomes stable. With the passage of SB 390, we're somewhere in the middle stages of this evolutionary model.

A fast-motion overview of recent developments looks like this: In an effort to achieve multiple energy objectives, recently promulgated federal regulations have encouraged a significant increase in competition among electrical producers at the wholesale level by compelling utilities to open their transmission lines to competitors at nondiscriminatory rates. Wholesale competition is fueling demands for similar restructuring at the retail level, which is largely a matter of state jurisdiction. Driven initially and primarily by industrial states with high electricity rates, state policy makers are moving to replace the regulation of power generation with customer choice and competition.

A slower, more methodical summary can easily get swamped in details—here are just a few. No single event triggered restructuring. A case could be made that the interest in decentralizing and diversifying fuel sources in the U.S. (which is one anticipated outcome of partial deregulation) is rooted in the experience of the energy crisis of the 1970s, which was precipitated in part by a Middle East war and the accompanying OPEC embargo, and which revealed how dependent the country had become on foreign oil. This situation stimulated Congress to support investments in nuclear power and alternative energy supplies. The 1980s brought burgeoning concerns about the national (and global) environmental impacts of fossil fuel combustion and the health, safety, and waste storage dilemmas associated with nuclear energy. This dovetailed with new discoveries and upgraded delivery systems for natural gas as well as strong public interest in and support for renewable forms of energy such as wind, solar, geothermal, and biomass. Meanwhile, many economists forecasted sizeable and sustained increases in the demand for electricity, and electric utilities continued to build large and increasingly expensive power plants.

A largely unforeseen result of this combination of decisions and expectations was an overbuilt industry (not to mention the irony of historically unprecedented dependence on foreign oil). Consumers, especially firms requiring large amounts of electric power to fuel (continued on page 4)

ELECTRIC UTILITY
INDUSTRY RESTRUCTURING
TRANSITION ADVISORY COMMITTEE
Room 138, State Capitol
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

SENATE MEMBERS
Fred Thomas, Chairman
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Todd Everts
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A Message from the Chairman...

As you may have noticed, it's been a very interesting past few months. Following two special session calls, three initiatives and some interesting editorials, one wonders what's next.

Well, I would like to say it will be all green grass and roses, but I am sure the interesting times are not over. But hey, remember, this is a very substantial matter of public policy and complete agreement would be unheard of!

Our committee is doing just fine, but some of our energy has been spent on getting more information out to the public and others so there is more knowledge about this subject on the street.

We are now going to spend our remaining time on recommendations to the Governor and Legislature for the next session.

One thing I want to point out regarding the pending sale of MPC's generation assets, I have a feeling the prospective bids they received were quite good. Remember the higher the ultimate sale price, the more money left over to pay off the fixed (stranded) costs. This will help every consumer, large and small.

If you have inquiries of the TAC or our Legislative Staff, please contact us! Information, data, or questions? Let us know. Let us help.

Fred Thomas, Chairman

Glossary...

PURPA - The Public Utility Regulatory Policies Act of 1978, passed by the U.S. Congress. The statute requires states to create markets for cogenerators and small power producers who use renewable energy resources and meet certain efficiency and ownership standards. It also mandates that state regulators set the price of power from such qualifying facilities based on avoided costs.

Qualifying Facility (Qf) - Under PURPA, Qfs are allowed to sell their electricity output to the local utility at avoided cost rates. To become a Qf, the independent supplier must produce electricity with a specified fuel type (cogeneration or renewable energy), and meet certain ownership, size and efficiency criteria established by the Federal Energy Regulatory Commission.

Cogeneration - A cogeneration facility produces electricity from heat or steam generated by an industrial process; i.e., energy that would otherwise be wasted is used to generate electric power.

FERC - The Federal Energy Regulatory Commission is a quasi-independent authority within the Department of Energy with jurisdiction over interstate electricity sales, wholesale electric rates, hydroelectric licensing, natural gas pricing, oil pipeline rates, and gas pipeline certification.

ContACTs:

Senator Fred Thomas is the TAC Chairman, 3566 Holly Lane, Stevensville, MT 59870-6634; (406) 777-5005.

The TAC Education Subcommittee Chairman is Dave Wheelihan, Exec. Director of the Montana Electric Cooperatives Association, Box 1306, Great Falls, MT 59403; (406) 761-8333. Other members are Bob Nelson, Roma Taylor, Alan Davis, and Stephen Bradley.

The Public Service Commission Liaison Group is chaired by Senator J.D. Lynch, 527 W. Mercury Street, Butte, MT 59701-1629; (406) 496-2150. Other members are Rep. Joe Quilici, Judi Johansen, Don Quander, and Stan Dupree.

The Universal Systems Benefits Programs (USBPs) Subcommittee Chairman is Rep. Ernest Bergsagel, HC 84, Box 8045, Malta, MT 59538-9701; (406) 658-2154. Other members are Don Quander, Kathy Hadley, Gene Leuwer, and Perry Cole.

The Taxation Liaison Group is chaired by Rep. Bill Ryan, 8 18th Ave. South, Great Falls, MT 59405-6634; (406) 761-8333. Other members are Bob Anderson, Perry Cole, and Sen. Walter McNutt.

Updates...



International Brotherhood of Electrical Workers

Since the passage of SB 390 all employees of Rural Electric Cooperatives (Cooperatives) and investor owned utilities (IOUs) have viewed electric utility deregulation as the hot topic of their careers. These employees entered into employment with Montana's IOUs and Cooperatives with the intention of applying their skills as the *quid pro quo* for a living wage and continued employment until retirement. Montana Power Company's sale of generation facilities directly affects 499 employees. The sale also affects many more employees as the duties historically performed for generation and the utility are condensed to only utility matters. The bargaining unit personnel affected are predominately skilled craftsmen. The remainder are management and non-bargaining administrative employees. All are "head of the family" type jobs.

It seems logical that if an existing utility is the buyer, a consolidation of some of the required services would occur. This could put many jobs in danger. The same could happen if an existing non-utility generation company would acquire the plants. If a newly established entity is successful, there is a good chance many employees (management and administrative) would be provided an opportunity to transfer to the new owner. As part of the sale, MPC offers its plants with a fully staffed and highly trained workforce. This will provide an opportunity for existing employees to demonstrate their abilities to the new owner. MPC has been harshly criticized by some interveners for addressing employee concerns as part of the sale because they believe it has the effect of devaluing the assets. They evidently do not view employees as an asset to the sale as does the IBEW, the Company, and quite possibly the new owners. MPC has stated their intentions regarding existing employees and those intentions do seem honorable. The unions desire to have those good intentions in writing. It only seems just, that these employee costs that have arisen as a direct result of legislation should be included in the rate base.

For more information contact Stan Dupree, IBEW-Local 44, in Butte at (406) 723-3203.

Natural Resources Defense Council & Renewable NW Project

Montana's electricity restructuring law guarantees that "public-purpose" benefits will be provided to utility customers during a four-year transition period from 1999 through 2002. These investments include cost-effective energy-conservation measures, low-income weatherization, and the above-market costs of renewable-power projects and applications.

Examples of energy conservation, or efficiency, measures include compact-fluorescent lamps, water heater wraps, wall and ceiling insulation, as well as super efficient appliances, motors and heating and cooling systems. Energy-efficiency improvements in homes and businesses reduce customers' electric consumption, delay the need for building new generating plants, create family-wage jobs in local energy-services companies and minimize everyone's electric bills over the long run.

Examples of renewable power investments include commercial-scale wind farms and on-site solar applications. Public-purpose funds could be used to buy down the price of qualifying renewable power offered by suppliers for sale to customers. Montana's method of funding public purposes is consistent with a competitive electricity supply market. All customers, large and small, are assessed a small, nonbypassable charge by their distribution company to fund these programs, regardless who their electric supplier is. How small is the charge? An average Montana residential customer will pay only 2.4% of her/his electric bill, or about \$1.20 of a \$50.00 monthly bill, for public-purpose programs. The end result of these investments: cheaper electric bills over the long-run, creation of local jobs in sustainable energy efficiency and renewable-power businesses, and a cleaner and healthier environment for future generations. NRDC and RNP are working to achieve this future.

Deborah Smith represents the Natural Resources Defense Council and the Renewable Northwest Project and can be reached at Reynolds, Motl and Sherwood (406) 442-3261 or at rms@ixi.net.

National Center for Appropriate Technology

The National Center for Appropriate Technology (NCAT) located in Butte, MT, has a long history of focusing its work on the energy needs and energy issues of low-income consumers. NCAT, along with low income advocates around the county, is especially concerned with the impact of restructuring on existing utility-funded low income rate assistance and energy conservation programs as well as programs promoting conservation and renewables to all customers. While many states, including Montana, have preserved existing low income programs through the restructuring transition, there is a need for funding mechanisms to make these programs permanent beyond the restructuring transition period.

With SB390 deregulating the generation component of the electrical utility industry in Montana, consumers are keenly interested in the effects on a number of consumer issues, such as shut-off protections, disconnection of services, credit evaluations, bill disputes, and collection practices. These issues are similar to those being faced in the other thirteen states who have passed some form of deregulation legislation.

NCAT has developed an internet website (<http://www.ncat.org/liheap>) the purpose of which is to compile and disseminate information on the impacts of utility deregulation, particularly as they affect low-income consumers.

This issue is complex and changes daily. We update the website as we find new information. We also provide links to other resources, including websites, with relevant information. NCAT's goal is to provide information to consumers so they can make informed choices in the new, deregulated energy market and protect themselves against unfair or fraudulent marketing practices.

Contact: Kathy Hadley, NCAT, 406-494-4572 or kathyh@ncat.org

(Continued from page 1)

production processes, found themselves locked into rates that reflected excess capacity rather than the availability of cheaper sources of power. Utilities fulfilling a federal mandate to purchase power from nonutility power generators below were similarly locked into contracts for high-priced electricity.

Price disparities are another force behind restructuring. The difference between regulated retail electricity prices and lower, more competitive wholesale costs has driven some customers--especially those with large electricity bills--to seek access to the wholesale market. The widening price gap came about through policy decisions taken at the federal level, which are briefly summarized below. Another type of price disparity also figures into the picture. Significant differences in energy prices among industrial states affect economic development. Companies with multiple manufacturing sites and relatively high demand for electrical power make siting and expansion decisions on the basis of comparative costs. State governments eager to boost manufacturing investment in their jurisdictions therefore have an interest in promoting measures--such as restructuring--that will reduce the price of energy for large firms.

The combining of national energy policy with political and commercial pressure to make structural adjustments to a highly regulated industry spawned several pieces of federal legislation and subsequent regulatory decisions, including the following:

The 1978 **Public Utility Regulatory Policies Act (PURPA)** amended the Federal Power Act to allow nonutility generators to enter the wholesale market. Nonutilities are privately owned facilities that generate electricity for their own use and/or for sale to other commercial entities, such as investor-owned utility companies. PURPA was intended to encourage development of non-fossil energy sources to mitigate reliance on foreign oil. The Act established a class of power producer known as **Qualifying Facilities (Qfs)**, which have to employ cogeneration (see Glossary) or specified renewables in order to "qualify" for the guaranteed market for their power that is also provided for in PURPA. The Act requires a utility in whose territory the Qf is located to purchase the Qf's electricity at no more than the utility's "avoided cost", i.e., the incremental cost to the utility to produce or purchase the same amount of electricity. PURPA also mandated the interconnection of utilities.

Many nonutility wholesale producers of power found the size and type of requirements for Qf status too restrictive, and opted to forego the guaranteed market under PURPA and sell directly at negotiated prices. These so-called **Independent Power Producers (IPPs)**, along with a growing crop of Qfs across the country, helped to undermine the monopoly conditions under which state-regulated utilities operated. The proliferation of Qfs and IPPs has also added to the nation's generation capacity while new technologies and conservation measures have effectively reduced the growth in demand for power from traditional sources.

The 1982 **Energy Policy Act (EPACT)** authorized the Federal Energy Regulatory Commission (FERC) to establish rules for the sale of electricity between utilities on a wholesale basis. EPACT authorizes any entity generating electricity for the wholesale market to petition the FERC to order a transmitting utility to provide access to its lines. FERC's rules require utilities to allow other power producers to send electricity over the utility's lines for a reasonable, nondiscriminatory price.

In 1996, following a decision to allow market-based rates for wholesale transactions and require open access to transmission lines on a case-by-case basis, FERC issued **Order 888**, which essentially requires all utilities that own, control, or operate transmission lines to file nondiscriminatory open access transmission tariffs that offer competitors transmission service comparable to the service the utility provides itself. The order also required public utilities to "functionally unbundle" their wholesale operations, meaning they had to internally separate transmission from generation and marketing services. An accompanying **Order 889** required utilities to establish electronic information sharing systems so that transmission capacity could be measured and monitored.

Error Alert! SB 390 requires the "unbundling" of charges so that consumers can see how much they are paying for specific components of their energy bill. Unbundling will have no effect on the amount customers are charged for electric power supply and delivery. The February 1998 issue of the TAC Report included on page 5 two hypothetical examples of unbundled bills. The sample provided by Big Flat Electric Cooperative indicated increased charges, but these increases, it turns out, reflected the loss of a large customer (Pegasus Gold) to bankruptcy, and not to unbundling or any other aspect of restructuring. The mistake was innocent and unintentional--and regrettable. A clarifying comparison of a hypothetical current (bundled) bill with a future (unbundled) one will appear in the next issue of this newsletter.



Looking Ahead

September

17 - The Education Subcommittee will meet in the afternoon, in preparation for the next day's meeting of the full TAC. Time and place to be announced. Contact Stephen Maly 406-444-3064.

18 - TAC meeting, Helena, capitol bldg. Agenda, time & place will be publicized in late August. Contact Todd Everts or Stephen Maly 406-444-3064.

October

23 - Final TAC meeting prior to opening of 1999 Legislative Session. Contact TAC staff for further information.

November

1 - Deadline for report on TAC activities to the Legislature and the Governor.

The Sleeping Giant ...

By Jeff Martin, Research Analyst, Legislative Services Division
Senate Bill 390 directed the Revenue Oversight Committee (Committee) to examine the taxation of the electric industry in a competitive environment. Jim Kane, from Arthur Andersen, LLP, and a member of the NCSL partnership on state and local taxation of the electric industry, has characterized tax issues as the Sleeping Giant of electric industry restructuring.

For over fifty years state legislatures, including Montana's, have generally imposed higher taxes or discriminatory taxes on monopolistic electric utilities. Under the traditional rate making procedures, the cost of service approach has been used to establish electric utility rates. This approach allows utilities the opportunity to recover their prudently incurred costs and earn a reasonable return on investment. Taxes are one of the components of the cost of service. Many states impose taxes that apply exclusively to utilities (e.g., gross receipts taxes or electrical generation taxes) or apply a higher rate (e.g., to property taxes) as well as taxes that are applied uniformly to other businesses (e.g., corporate income taxes).

The days of regulated electric monopolies providing electricity in protected service territories are slowly coming to an end. Already 16 states have adopted some form of restructuring through legislation or through state public service commission orders. The electric industry is entering the realm of competitive markets. It is apparent to most state policy makers that the electric industry tax structure must be revitalized to ensure a smooth transition to competition.

In Montana, electric utilities are subject to the corporation license tax, the property tax, the electric energy producers' license tax (which nonregulated generators also pay), and to specific regulatory taxes and fees. It is the current property tax and the electric energy producers' license tax that may be the most troublesome in the transition to competition. The property tax rate on class nine centrally assessed property (including electric and natural gas utilities, telecommunications, and oil and gas pipelines) is 12%, or two times the rate applied to most other business property.



The tax effects of restructuring could undermine some sources of local government funding.

The Revenue Oversight Committee is looking at several issues related to electric industry property taxation. First, should property tax changes apply only to electric generation property or to all operating property of utilities? Second, should property tax changes also apply to all centrally assessed property as a means of aiding other emerging competitive markets? Third, how should the legislature deal with anticipated revenue erosion, particularly from the sale of

Montana Power Co. generating assets? Fourth, how do rural electric cooperatives fit into the scheme?

At the January 30, 1998, Committee meeting, Dennis Burr, Montana Taxpayers' Association (MonTax),

presented a proposal to reduce the tax rate on all class nine property (electric and natural gas utilities, telecommunications, and oil and natural gas pipelines) from 12% to 6% and to assess new taxes to make up for the loss in property tax revenue. The new taxes would include a 5% excise tax (sales tax) on final consumers in Montana of electricity, natural gas, and telecommunications services and an as yet unspecified replacement tax (perhaps a gross receipts tax) on oil and gas pipelines. In addition, the proposal would increase the electric energy producers' license tax from \$0.0002 to \$0.0008 per kilowatt hour to replace the property tax loss associated with electric utilities operating in the state, but not serving customers in the state.

At the April 3, 1998, Committee meeting, Committee staff presented the estimated property tax impact of the proposal for tax year 1997. The analysis showed that the property tax loss to local taxing jurisdictions and the state would be about \$81 million, with electric and natural gas utilities accounting for \$44.7 million of the loss. Telecommunications (\$16.7 million), oil and gas pipelines (\$12.8 million), and railroad and airline property (\$6.9 million) would account for the remainder. Because federal law prohibits discriminatory taxation of railroads and airlines, the tax rate applied to this class of property would fall from 6.31% to 4.56%.

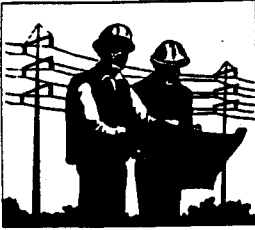
The average statewide reduction in taxable value would be 13.6%. In 20 counties the reduction in taxable value would be greater than the statewide average, and in many instances much greater. The greatest impact would be in Rosebud County (-41.7%), followed by, in order, Wheatland County (-32.6%), Sanders County (-32.2%), Golden Valley County (-28.3%), and Roosevelt County (-26.3%). In only six counties is the reduction in taxable value less than 5%.

The analysis is muddled by the sale of MPC generating assets. The Department of Revenue has estimated that the sale of the assets would result in a \$7.9 million loss in property taxes. The actual loss, if any, will be related to the sales price and to the taxable status of the successful bidder. Other owners of utility generating assets in Montana may also elect to sell their Montana generating assets. Another complication associated with the sale of generating assets is the impact on the unit value of remaining operating property owned by MPC and allocation of that value to the counties.

The MonTax proposal includes a fourfold increase in the electric energy producers' license tax to make up the additional revenue. Part of that increase would be borne by Montana customers through higher rates and by a shift of the tax to Montana consumers that is now exported. The increase in the license tax may impede the competitive position of in-state suppliers and exporters of electricity.

Montana's electric industry tax structure is relatively simple. Finding an equitable solution will not be so simple. There are likely to be many ripple effects to any changes in the structure.





Milestones in the Transition Process

1997

Senate Bill 390 is passed by the legislature and signed into law by the Governor

July 1—MPC and PacifiCorp file transition plans with the Public Service Commission

Aug. 26—MPC files revised transition Plan

Oct. 16—PacifiCorp files revised transition plan

Dec. 9—MPC announces its intention to divest itself of all its generation assets

1998

Jan. 6—TAC modifies schedule for MPC transition plan

March 24—PSC hearing on PacifiCorp revised transition plan commences

April 28—PSC hearing on MPC revised transition plan addressing first tier (pre-sale) issues only

June 24—PSC issues final order on MPC first tier issues

July 1—Rate moratorium enters into effect; large customers legally free to choose electricity suppliers

Aug. 25—PSC begins hearings on PacifiCorp transition costs, customer education and pilot programs

Nov. 1—TAC makes recommendations to legislature and governor re: energy assistance funding levels

Nov. 2—MPC Pilot Programs commence

Before Dec. 1—Implementation of Universal Systems Benefits Charges (USBCs)

1999

Jan. 1—56th Montana Legislature convenes

Five hundred copies of this public document were published at an estimated cost of \$.81 per copy for a total cost of \$406.00.

BiblioWeb Notes

Selected sources of information pertinent to electrical industry restructuring and closely-related topics.

1. Publications

The Restructuring of the Electric Power Industry: A Capsule of Issues and Events, National Energy Information Center (NEIC), Energy Information Administration, EI-30, Forrestal Building, Room 1F-048, Washington, D.C. 20585, (202)586-8800, or Email to: infoctr@eia.doe.gov.

Possible Effects of Competition on Electricity Consumers in the Pacific Northwest, Stan Hadley and Eric Hirst, Oak Ridge National Laboratory, Oak Ridge, Tennessee 37831, managed by Lockheed Martin Energy Research Corporation for the U.S. Department of Energy under contract No. DE-AC05-96R22464. Call the DOE in Oak Ridge at (603) 500 or request a photocopy from TAC staff.

2. Web Sites

<http://www.ferc.fed.us> will get you the U.S. Federal Energy Regulatory Commission, which bears responsibility for the (re)licensing of hydroelectric facilities and is a key agency in the overall restructuring process.

<http://www.naseo.org> posts information from and about the National Association of State Energy Officials.

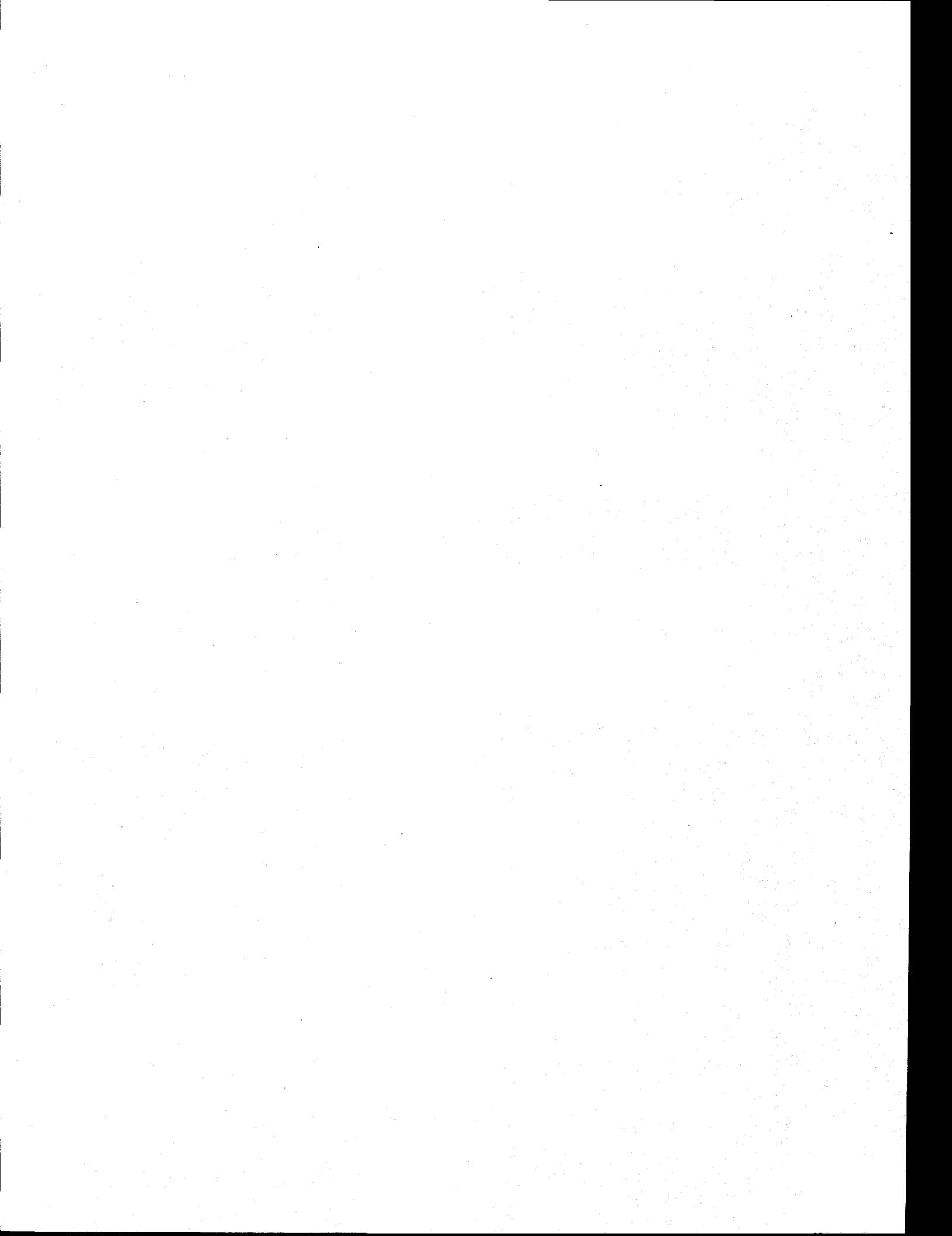
<http://www.local.org> is the location of the American Local Power Project, which takes a critical view of restructuring and offers information on energy alternatives and options to well-organized localities.

Disclaimer: The T.A.C. Report is designed to help educate and inform TAC members, the Legislature, and other interested persons about the transition processes mandated in and otherwise envisioned by supporters of Senate Bill 390; and to help meet the quarterly reporting requirements of the bill. The newsletter will routinely include regular features prepared by Committee staff as well as short articles and other invited submissions from various organizations and interest groups. In sanctioning and distributing this document, the TAC does not intend to confer any advantage—commercial, legal, or any other type—on any public or private entity.

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The TAC Report
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Room 138, State Capitol
Helena, MT 59620-1706

APPENDIX 6



Collaborative on Customer Education and Pilot Programs

December 30, 1997

Commissioner Dave Fisher
Chairman
Montana Public Service Commission
P.O. Box 202601
Helena, MT 59620-2601

Dear Chairman Fisher:

I write to you on behalf and at the direction of the Collaborative on Customer Education and Pilot Programs. This Collaborative met on five occasions from September through December 1997 to seek agreement on two topics: a statewide customer educational message and pilot programs for introducing choice to residential and small commercial customers. The enclosed document is the product of this effort. It sets forth the agreement reached and lists the parties to the agreement. Please note that in this context agreement means that the parties listed as agreeing do not necessarily agree with all aspects of the final product but do not disagree enough to warrant opposition to the overall package.

With respect to the customer education message, the Collaborative agreed that investor-owned utilities should submit specific education messages to the staff of the Montana Public Service Commission for approval to ensure their objectivity and neutrality and consistency with the Collaborative consensus script set forth in section 2.5 of the enclosed document. On behalf of the Collaborative, I ask therefore that the Commission allow its staff to carry out this role.

Thank you.

Sincerely,

Gerald Mueller
Facilitator
Collaborative on Customer Education and Pilot Programs

CC: Transition Advisory Committee on Electric Utility Industry Restructuring

Collaborative on Customer Education and Pilot Programs

December 30, 1997

**Senator Fred Thomas
Chairman
Transition Advisory Committee on Electric Utility Industry Restructuring
Room 138
State Capitol Building
Helena, MT 59620**

Dear Chairman Thomas:

I write to you on behalf and at the direction of the Collaborative on Customer Education and Pilot Programs. This Collaborative met on five occasions from September through December 1997 to seek agreement on two topics: a statewide customer educational message and pilot programs for introducing choice to residential and small commercial customers. The enclosed document is the product of this effort. It sets forth the agreement reached and lists the parties to the agreement. Please note that in this context agreement means that the parties listed as agreeing do not necessarily agree with all aspects of the final product but do not disagree enough to warrant opposition to the overall package.

Thank you.

Sincerely,

**Gerald Mueller
Facilitator
Collaborative on Customer Education and Pilot Programs**

Working Document for the Collaborative on Customer Education and Pilot Programs

December 30, 1997

1.0 Introduction

- 1.1 The 1997 legislature enacted the Montana Electricity Industry Restructuring and Customer Choice Act, Senate Bill 390. This act requires investor-owned utilities to file with the Montana Public Service Commission (MPSC) a transition plan including an educational plan and pilot programs for introducing choice to residential and small commercial customers. Electric cooperatives that choose to offer their customers choice must certify to the MPSC they have adopted a transition plan consistent with the provisions of this act, including the requirements for an educational plan and pilot programs.
- 1.2 Montana Power Company (MPC) initiated the Collaborative on Customer Education and Pilot Programs (Collaborative) so that the interested parties might jointly seek agreement on the development and implementation of a statewide customer education message and pilot programs for customer choice.
- 1.3 Using PSC service lists, MPC sent invitations to a first meeting of the Collaborative on September 23, 1997.
- 1.4 The Collaborative met five times from September 23 through December 9, 1997. The Collaborative sought agreement on two topics: a statewide customer educational message and pilot programs for introducing choice to residential and small commercial customers.
- 1.5 The purpose of this document is to record the results of the deliberations of the Collaborative and the agreements it reached.

2.0 Customer Educational Message

- 2.1 The Collaborative (see 2.6 below for a listing of its participants) agreed that the purpose of the statewide educational message should be to provide to mass account customers, i.e., residential and small commercial customers, consistent and objective information that will enable them to make informed choices of suppliers of electricity and related energy services.
- 2.2 The customer education messages in section 2.5 are developed as terms, tones, and directions that will provide residential and small commercial customers with consistent and objective information that will enable them to make informed choices of suppliers of electricity and related energy services. These messages are meant to be generic enough that any utility in Montana, or an independent resource facilitating customer education, can take the message, apply their own creative treatment to it and use it with their own customers--setting the stage for customer choice of electricity supply. How the messages are developed and creatively presented is left to the individual utility. Actual wording may vary between utilities, but the intent will be consistent with the messages in section 2.5.

2.3 Disclaimer - Agreement by the Collaborative participants on the customer education messages in section 3.5 does not constitute endorsement of any specific educational materials developed by any utility or other entity.

2.4 Investor-owned utilities should submit specific education messages to the staff of the MPSC for approval to ensure their objectivity and neutrality and consistency with the Collaborative consensus script.

2.5 The Collaborative (see 2.6 below) agreed to the terms, tones, and directions of the following customer messages:

2.5.1 General Message: Making Choices that Matter in Energy¹

The energy industry is changing. In Montana, like other parts of the country, new legislation is setting the stage for change.

Historically, a single utility has provided the supply and delivery of electricity to its customers.

The transmission and distribution (delivery) of electricity will continue to be regulated. It is the supply of electricity (generation) that is becoming competitive. The electricity you buy will continue to be delivered over the same wires and poles by your current utility.

Over the next several years, you will have the ability to choose the supplier of your electricity. You may choose a new supplier or you may choose to do nothing now. Eventually, you will have to make a decision as to who will provide your electricity supply. Competing suppliers will offer different prices, services, and other options related to electricity generation.

Your choice of suppliers of electricity will not change the reliability and safety of your electric delivery service. Calls for service or outages should be directed to your current utility who will still provide safe and reliable service regardless of who you choose to supply your electricity.

Choosing a new electricity supplier affects only the supply of electricity. Supply makes up between 1/3 and 1/2² of most Montanans' total electric bill. This is the part of your bill which may be lowered through choice.

Customer choice in Montana begins as early as July 1, 1998 with some pilot programs starting the transition for residential and commercial customers. To find out more about when customer choice for electricity will be available to you or to get more information, please contact: your current electric utility, the MPSC at 1-888-XXX-XXXX or the MPSC Website at www.psc.state.mt.us, or an independent resource at 1-888-XXX-XXXX.

2.5.2. Specific Messages

a. Choosing a Supplier

Customer choice allows you more freedom in managing your energy decisions. You will choose a licensed supplier from whom you will buy electricity. You may choose the options which best meet your interests and needs—low price, environmentally-friendly or "green" power, locally generated electricity, special sign-up incentives, power purchased through a group you belong to, or special billing and energy services provided along with supply.

Just as you do with other products and services, you will probably sign a contract for electricity service with your supplier. Suppliers must be licensed by the MPSC and follow customer protection rules. For instance, your supplier cannot be changed without your authorization. You are responsible for understanding the terms of the contract to include price, length of arrangement, and any services or options included in the price and agreement.

Shop around. Compare the prices and options different suppliers offer. Find out how the supplier's offer will affect your monthly bill. Ask how customer service is handled, when and how you will be billed, what the customer fees are, how you go about changing suppliers, and how any other questions you have will be addressed. Make sure the supplier is licensed by the MPSC. A list of licensed electricity suppliers and their contacts is available by calling the MPSC at 1-888-XXX-XXXX or through its web site at www.psc.stat.mt.us or by contacting the independent resource at 1-888-777-7777. You may also check with the suppliers for more information about the products and services they offer.

b. The New Electricity Bill

As part of the move to competition, the way information is presented on your electric bill will change. Since Supply and Delivery have been provided by one company in the past, the price for electricity has been "bundled" to include the supply, transmission and distribution costs along with a services charge.

The electric bill of the future will break out, or "unbundle" the costs of supply and distribution.

Supply makes up between 1/3 and 1/2 of most Montanans' total electric bill. This is the part of your bill which may be affected by the choice you make.

Competitive Transition Charges (CTC) (stranded costs) may also appear on the bill. These charges are to cover some costs of the current utility associated with moving from the monopoly of the past to the new competitive environment.

Universal Systems Benefits Charge (USBC) will be listed on the bill. These charges are used to fund public purpose programs and services such as low income weatherization and energy assistance, energy efficiency programs, and the development of renewable energy resources.

Distribution Service Charges are the costs associated with planning, constructing, operating, and maintaining the local wires and poles that deliver electricity to your

home or business.

Transmission Charges for moving the electricity from the place where it is generated to the local wires near your home or business.

Other Charges for optional services, if any.

Include generic mock bill—with language that actual bill that this is for illustrative purposes only. Actual cost break downs will vary by utility.

2.5.3 Glossary of Terms

Supplier—A licensed provider of electric energy. The supplier may own electric generating facilities or may purchase electric supplies from others. Suppliers include aggregators, brokers and marketers of electricity.

Aggregator—A supplier who brings together a group of customers to buy electricity. The “aggregated” group of customers is like a buying club or co-op, pooling their buying power.

Power Brokers/Marketers—Suppliers who facilitate the purchase of electricity between generators of electricity and individual customers or groups of customers.

Restructuring—The separation of electricity supply and delivery of electricity. The move from the fully regulated electricity industry to competition for the supply of electricity. Delivery of electricity remains regulated.

Competitive Transition Charges (CTCs) or stranded costs — Charges are to cover some costs of the current utility associated with moving from the monopoly of the past to the new competitive environment.

Universal Systems Benefits Charges— charges are used to fund public purpose programs and services such as low income weatherization and energy assistance, energy efficiency programs, and the development of renewable energy resources.

Utility—Your “current utility” is the investor-owned utility or rural electric cooperative from which you currently receive electricity supply and delivery of service. In the future your utility will be the company that delivers your electricity.

Unbundling—The separation into parts of the various charges which make up the “traditional” utility bill. While all charges have historically been “bundled” into the meter charge and the kwh charge, at a minimum, the new unbundled bill will separate out: supply, competitive transition charges (stranded costs), universal systems benefits charges, distribution service charges, and transmission charges.

Regulated—when used in reference to utilities, means that prices, operating requirements and processes are set through rules by a regulatory agency such as the Montana Public Service Commission (MPSC) or the Federal Energy Regulatory Commission (FERC)

Deregulated—Products, processes, and services which have been regulated in the past but are being moved into the competitive arena, outside the traditional regulator's authority.

- 2.6 The Collaborative participants agreeing to the provisions of section 2.0 include:
- | | |
|-----------------|----------------------------------------------------------------------------|
| Will Rosquist | Montana Public Service Commission (PSC) |
| Kate Whitney | PSC |
| Gregg Groepper | Energy Share of Montana |
| Mary Wright | Montana Consumer Counsel (MCC) |
| Patrick Judge | Montana Environmental Information Center |
| Jim Nybo | Citizen |
| Fred Rettenmond | Bonneville Power Administration (BPA) - Spokane |
| Glenn Wheeler | Montana Power Company (MPC) |
| Steve Winter | MPC |
| Deb Young | MPC |
| Tom Schneider | Consultant Montana Department of Health & Human Services |
| Tom Power | Human Resources District XI |
| Fred Rettenmond | Bonneville Power Administration (BPA) - Spokane |
| Alan Davis | Department of Environmental Quality (DE) |
| Gary Willis | Montana Power Trading & Marketing |
| Connie Colter | PacifiCorp |
| Jan Mitchell | PacifiCorp |
| Nancy Zalutsky | Colstrip Energy Limited Partnership/Yellowstone Energy Limited Partnership |
| Ron Perry | Commercial Energy |
| Chris Imhoff | Citizen |
| Tim Gregori | Big Horn Electric Cooperative |
| Dave Wheelihan | General Manager, Montana Electric Cooperative Association |

3.0 Pilot Programs

- 3.1 The Collaborative (see 3.6 below) agreed that the purpose of the pilot program is to provide a pathway to effective customer choice for residential and small commercial customers and to gather information regarding:
- a. The level of demand for electricity supply choice and the availability of market prices for smaller customers;
 - b. The best means to encourage and support the development of sufficient markets and bargaining power for the benefit of smaller customers;
 - c. The electricity suppliers' interest in serving smaller customers and the opportunities in providing service to smaller customers; and
 - d. Experience in the designing and delivering unbundled retail services to smaller customers (see MCA 69-8-104).
- 3.2 Disclaimer - The Collaborative chose not to endorse any pilot program. Instead it sought to identify and then reach agreement on factors that might lead to the success of pilot programs.

3.3 Individual Collaborative participants identified the following factors from three perspectives, supplier, customer, and local distribution company, that might lead to the success of pilot programs. Factors on this list are not necessarily agreed to by the Collaborative.

3.3.1 Supplier factors that might lead to success include:

- a. Opportunity to make money;
- b. Known benchmark energy price;
- c. Certain transition to choice;
- d. Easy access to customers;
- e. Reasonable licensing requirements;
- f. Time for suppliers to establish an identity (Montana transition period provides this time);
- g. Open customer enrollment period, i.e. no deadline for signing up;
- h. All customers eligible to enroll, i.e. existing utilities do not act as the gate keeper for supplier access to customers;
- i. If a cap on the total number of participants in the pilot program exists, a running total of the customers signing up with specific suppliers must be kept so that suppliers will know when the cap is reached;
- j. The size of the pilot group and the timeline for phasing to full customer choice needs to be defined and attractive to suppliers;
- k. Opportunity to aggregate customers to reduce transaction costs;
- l. Technical mechanisms necessary to implement choice, e.g. metering, billing, and transmission scheduling are in place;;
- m. In addition to energy, other services such as metering and billing can be offered to customers;
- n. Simple process and criteria for signing up customers;
- o. Minimization of barriers to niche markets;
- p. Neutral sources of information;
- q. Limit the pilot program market share of the incumbent utility;
- r. Utility supply entities are allowed to compete; and
- s. Collection of Information about the market for small customers.

3.3.2 Customer factors that might lead to success include:

- a. Easy, simple supplier choice;
- b. Consistent with supplier-customer contracts, easy opportunity to switch to and from suppliers;
- c. Customer protection and complaint mechanism in place;
- d. Privacy, i.e. customer controls access to her or his electricity usage information;
- e. No slamming allowed, i.e. switching of a customer's electricity suppliers without the customer's authorization;
- f. A period for a customer to change his or her mind about supplier selection;
- g. Clear, standard, comparable, neutral information;
- h. Neutral source of information available to consumers;
- i. Lower prices;
- j. Minimal customer cost and service risk from supplier choice;
- k. Customer chooses whether and how to participate in the pilot program;
- l. Comparable transmission and distribution service regardless of supplier choice;
- m. Reason to change electricity supplier;
- n. Disclosure and labeling by a supplier of its generation sources and environmental

impacts;

- o. Ability to choose different pricing, products and services;
- p. Ability to be aggregated;
- q. Pilot program continuity, i.e. dependable supplier;
- r. Understandable bill;
- s. Provider of last resort;
- t. Local distribution company code of conduct;
- u. A clear, direct and workable path to deal collectively with possible suppliers; and
- v. Collection of Information about the market for small customers.

3.3.3 Local distribution company factors that might lead to success include:

- a. Minimal impact on non-participating customers;
- b. Reasonable process to facilitate supplier changes;
- c. Reasonable minimum period before switching suppliers;
- d. Not accountable for supplier performance;
- e. Rule for allocating partial customer payments;
- f. System load and cost balance (supply and distribution);
- g. Distribution company standards of conduct;
- h. Customer protection mechanism in place;
- i. Clarity of procedures and accountability for metering;
- j. Infrastructure to implement choice;
- k. Timely education program; and
- l. Right to have an identity and relationship to customer that doesn't advantage affiliate.
- m. Total number of pilot program participants is capped consistent with the size of the pilot group and the timeline for phasing to full customer choice; and
- n. Collection of Information about the market for small customers.

3.4 After discussing the lists in section 3.3 above, the Collaborative (see section 3.5 below for a listing of its participants) reached agreement³ that the following factors would might lead to the success of pilot programs. Any of the section 3.3 list of factors that were not agreed to by all participants were not included in section 3.4.

The order does not specify any ranking of importance.

- a. Opportunity for suppliers to make money;
- b. Known benchmark energy price ;
- c. Easy supplier access to customers;
- e. Reasonable supplier licensing requirements;
- f. Time for suppliers to establish an identity (Montana transition period provides this time);
- g. Open customer enrollment period, i.e. no deadline for signing up;
- h. All customers eligible to enroll, i.e. existing utilities do not act as the gate keeper for supplier access to customers;
- i. If a cap on the total number of participants in the pilot program exists, a running total of the customers signing up with specific suppliers must be kept so that suppliers will know when the cap is reached;
- j. The size of the pilot group and the timeline for phasing to full customer choice needs to be defined and attractive to suppliers;
- k. Opportunity to aggregate customers to reduce transaction costs;
- l. Technical mechanisms necessary to implement choice, e.g. metering, billing, and transmission scheduling are in place;

- m. In addition to energy, other services can be offered to customers;
- n. Simple process and criteria for signing up customers;
- o. Minimization of barriers to niche markets;
- p. Neutral sources of information;
- q. Collection of Information about the market for small customers;
- r. Easy, simple supplier choice;
- s. Consistent with supplier-customer contracts, easy opportunity to switch to and from suppliers;
- t. Customer protection and complaint mechanism in place;
- u. Privacy, i.e. customer controls access to her or his electricity usage information;
- v. No slamming allowed, i.e. switching of a customer's electricity suppliers without the customer's authorization;
- w. A period for a customer to change his or her mind about supplier selection;
- x. Clear, standard, comparable, neutral information;
- y. Minimal customer cost and service risk from supplier choice;
- z. Customer chooses whether and how to participate in the pilot program;
- aa. Comparable transmission and distribution service regardless of supplier choice;
- bb. Reason to change electricity supplier;
- cc. Meaningful, complete, and accurate disclosure and labeling by a supplier of its generation sources and environmental impacts as required by the MPSC;
- dd. Ability of customers to choose different pricing, products and services;
- ee. Ability of customers to aggregate;
- ff. Pilot program continuity, i.e. dependable supplier;
- gg. Understandable bill;
- hh. Provider of last resort;
- ii. Individual and collective ability of customers to work directly with suppliers;
- jj. Minimal impact on non-participating customers;
- kk. Reasonable process to facilitate supplier changes;
- ll. Reasonable minimum period before switching suppliers;
- mm. Local distribution company is not accountable for supplier performance;
- nn. Rule for allocating partial customer payments;
- oo. System load and cost balance (supply and distribution);
- pp. Clarity of procedures and accountability for metering;
- qq. Infrastructure to implement choice;
- rr. Timely education program;
- ss. Right to have an identity and relationship to customer that doesn't advantage affiliate; and
- tt. The size of the pilot group and the timeline for phasing to full customer choice needs to be defined.

3.5 The Collaborative participants agreeing to the provisions of section 3.4 include:

Will Rosquist	Montana Public Service Commission (PSC)
Kate Whitney	PSC
Gregg Groepper	Energy Share of Montana
Mary Wright	Montana Consumer Counsel (MCC)
Patrick Judge	Montana Environmental Information Center
Jim Nybo	Citizen
Fred Rettenmond	Bonneville Power Administration (BPA) - Spokane
Glenn Wheeler	Montana Power Company (MPC)
Steve Winter	MPC

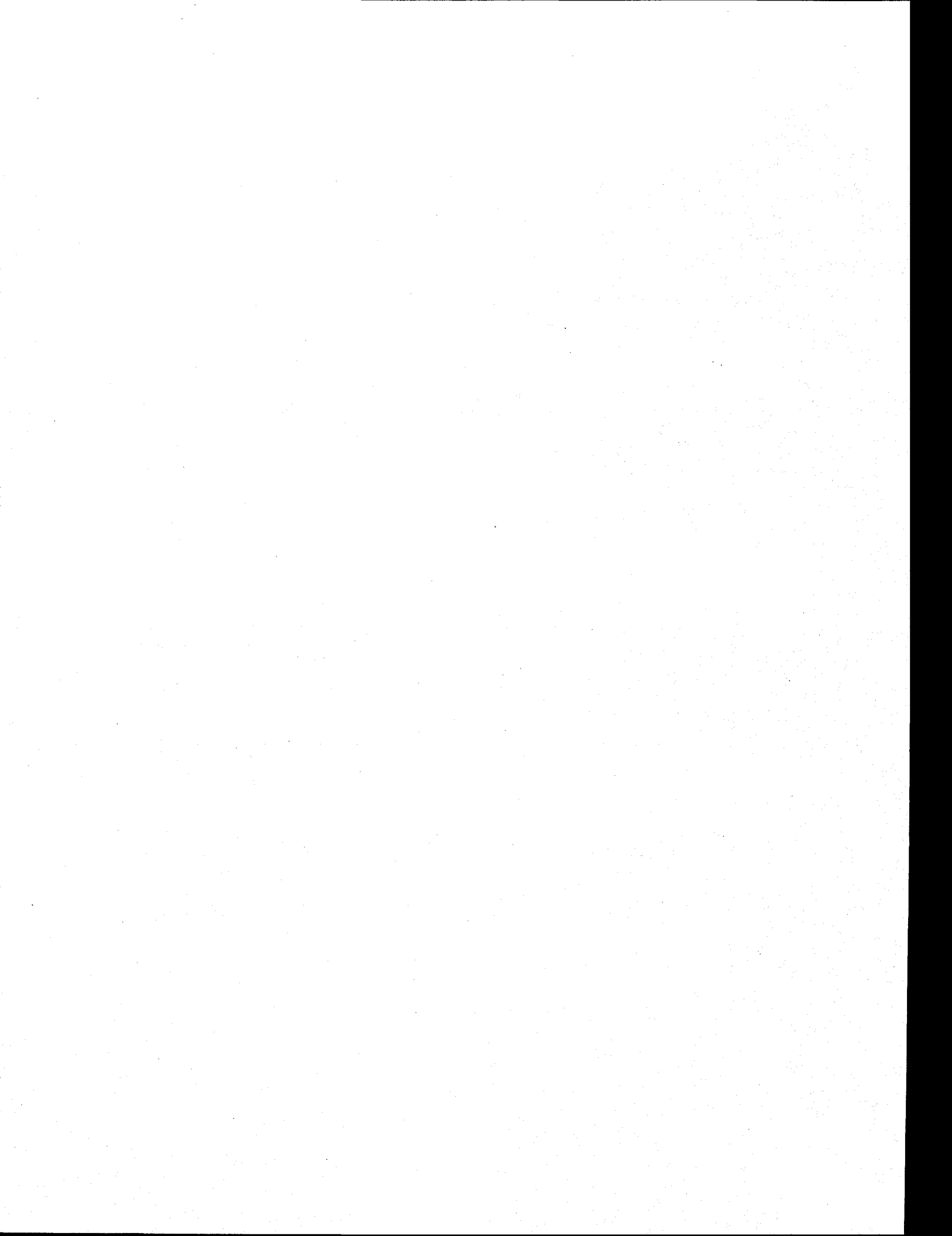
Deb Young	MPC
Tom Schneider	Consultant for Montana Department of Health & Human Services
Tom Power	Human Resources District XI
Fred Rettenmond	Bonneville Power Administration (BPA) - Spokane
Alan Davis	Department of Environmental Quality (DE)
Gary Willis	Montana Power Trading & Marketing
Connie Colter	PacifiCorp
Jan Mitchell	PacifiCorp
Nancy Zalutsky	Colstrip Energy Limited Partnership/Yellowstone Energy Limited Partnership
Ron Perry	Commercial Energy
Chris Imhoff	Citizen
Tim Gregori	Big Horn Electric Cooperative
Dave Wheelihan	General Manager, Montana Electric Cooperative Association

End Notes:

1. This is a place holder title. Each utility will create its own title this through its creative treatment. The title is intended to evoke interest in the subject.
2. Utilities are expected to replace the 1/3 to 1/2 range with values appropriate to their service territories.
3. Agreement means that the parties listed as agreeing do not necessarily agree with all aspects of the final product but do not disagree enough to warrant opposition to the overall package.



APPENDIX 7



May 26, 1998

ISSUES CONCERNING WATER RIGHTS. OWNED
BY MONTANA POWER COMPANY

Questions asked by Sen. Hurwitz through LEPO

1. What is the flow rate for each Montana Power Company (MPC) water right?

Answer. Major flow rates claimed by MPC for each of its Missouri and Clark Fork River hydropower facilities are summarized in Table 1 below. For a more detailed summary of MPC's water right claims, refer to attachment 1.

Table 1.

Dam	Claimed Right	Average Flow at Dam	Claimed Priority Date
Madison	1,650 cfs	1,761 cfs	8/24/1895
Holter	7,100 cfs	5,498 cfs	4/30/1918
Hauser	4,740 cfs	5,498 cfs	6/23/1905
Black Eagle	3,300 cfs	7,651 cfs	6/1/1892
Rainbow	3,500 cfs	7,651 cfs	9/16/1908
Cochrane	10,000 cfs	7,651 cfs	6/16/1955
Ryan	5,900 cfs	7,651 cfs	8/31/1915
Morony	8,280 cfs	7,651 cfs	12/20/1928
Mystic Lake	169 cfs	123 cfs	9/25/1916
Kerr	14,540 cfs	11,580 cfs	4/3/1920
Thompson Falls	~31,000 cfs	22,080 cfs	12/3/1906
Milltown	2,000 cfs	2,949 cfs	12/11/1904

2. What is the point of diversion for each MPC water right? The point of this question is to determine at what location MPC may insist on delivery of its claims.

Answer. The point of diversion is at each of MPC's dams. MPC would probably insist that the water be delivered to each of its facilities to maximize power generation.

3. What is the relationship between the flow rates claimed for MPC rights and average annual discharge for streams in which the Power company's claims are located? As an example, MPC owns claim 41 F-W-094373-00. This claim identifies a flow rate of 99,999.99 cfs for power generation connected with the operation of Hebgen Dam on the Madison River. The priority date of this claim is June 1, 1914. MPC also claims water right 41 F-W-094372-00 with a flow rate of 6,000 cfs for power generation at Hebgen Dam. It is unlikely that maximum flows in the Madison River near Hebgen Dam come even close to the combined flow rates of these claims. MPC's water right, at least for Hebgen Dam, are grossly exaggerated. It would be interesting to know the maximum historic flow rate MPC has diverted from the Madison River for delivery of water into Hebgen Reservoir. Such historic use represents the maximum amount of water to which MPC would be entitled.

Answer. A comparison between MPC flow claim and average annual flow at each dam is presented in Table 1. It appears that MPC probably designed turbine capacities at each facility based on available flows necessary to maximize its generation capability. At Thompson Falls, where it under designed its turbine capacity, additional turbines were added to better utilize available river flows.

MPC claimed multiple water rights for each of its facilities. For each project, there is at least one claim asserting a storage volume. Typically in the claim MPC asserts that, "The volume claimed is the amount necessary to fill the storage reservoir at any time." In the storage claims, MPC usually asserts a storage volume for use through the turbine(s) at that facility and at any downstream facilities. For example: MPC's claim for storage at the "old" Canyon Ferry dam asserts, "The water stored behind the Canyon Ferry Dam is used for hydroelectric generation at Hauser, Holter, Black Eagle, Rainbow, Ryan, Cochrane, and Morony dams."

The relationship between flow rate and average annual discharge in MPC water right claims has not been resolved through the adjudication process. MPC filed the following three water right claims for storage at Hebgen Lake and two for the Madison Project on Ennis Lake.

Claim	Facility	Use	Flow Rate	Volume	Priority Date
W094371	Hebgen	Storage	2,000 cfs	Volume required to fill reservoir at any time,	4/30/1906
W094372	Hebgen	Storage	6,000 cfs	Volume required to fill reservoir at any time,	5/29/1906
W094373	Hebgen	Storage	99,999 cfs	Volume required to fill reservoir at any time,	6/1/1914
		flow subtotal			
W094375	Madison	Power Gen.	1,650 cfs	1,127,120 Acre Feet	8/24/1895
W094276	Madison	Storage	19,720 cfs	Volume required to fill reservoir at any time,	8/24/1895
		flow subtotal			

DNRC's planning report, "The Framework Report - Volume One, " identifies the active storage

for Hebgen Lake as 337,500 acre-feet and 42,060 acre-feet for Ennis Lake. The United States Geological Survey Water-Data Report MT-96-1, "Water Resources Data, Montana, Water Year 1996," reported a record stream flow on the Madison River below Hebgen and another below Lake Ennis near McAllister, Mt. The Hebgen gage reported an 87-year average discharge of 1,010 cfs and average volume of 731,700 acre-feet [adjusted for storage]. The maximum discharge was 10,200 cfs observed August 17, 1959 in conjunction with an earthquake. The maximum natural discharge was 5,090 cfs on June 3, 1943.

Madison gage below Ennis Lake recorded a maximum instantaneous peak flow of 9,550 cfs on June 12, 1970 an annual mean flow of 1,761 cfs, The highest annual mean flow was 2,423 cfs and annual volume was 1,276,000 acre-feet.

4. Was Hebgen Dam actually constructed in 1914? If not, when did power generation [begin] at this site begin? Is the claimed priority date of 1914 consistent with first usage of water at Hebgen? Similar questions apply to all of MPC's water rights.

Answer. Hebgen is a storage reservoir and there is no power generated at this dam. Hebgen was constructed in 1915 and, hence, water was probably not stored prior to then. Claimed dates for water rights commonly precede the date of actual use and this could be the case for other MPC claims as well. There are claims for Hebgen storage that date back to 1906.

All three water right claims for Hebgen are for storage which is to be released for downstream power generation at Madison, Hauser, Holter, Black Eagle, Ryan, Rainbow, Cochrane and Morony dams. Priority dates for these claims range from 1906 to 1914 (see attachment 1). In claim number W094371, MPC has included a page from the 1915 MPC annual report which state's, "The final completion of the Hebgen Dam, creating the seventh largest reservoir in the world, was accomplished during 1915." The issue of relating the early priority dates to actual use is a question of diligence and can be answered in the state adjudication process.

5. MPC has claimed water rights 41 F-W-CM75-00 and 41 F-W-OW78-00 for power generation at Ennis Lake Dam. The flow rates for these claims are not specified in the Abstract for the Temporary Preliminary Decree of the Madison River. What flow rates does MPC assert it is entitled to receive in connection with these water rights claims?

Answer. Two water rights (W094375 and W094376) were asserted by MPC for the Madison Project - Ennis Lake Dam. MPC asserted 1,650 cfs (up to a volume of 1,127,120 acre-feet) and 19,720 cfs up to an unspecified numeric volume for multiple reservoir fills. The Temporary Preliminary Decree lists a flow rate of 1,650 cfs up to 1,127,120 acre feet per annum for claim W094375. The Montana Water Court did not list a flow or volume for claim W094376 and further stated, "The Water Court finds no right for this claim as it is duplicated by Claim no. W094375." MPC objected to this ruling and entered arguments against this finding. The case has not been heard and Judge Joseph B. Gary issued an order staying this proceeding. This stay holds the proceeding until decrees have been issued for 41I, 41A, 41B, 41Q, and 41QJ. The

other mainstem Missouri River MPC power generation and storage claims are included in Basins 41I and 41QJ.

6. MPC's failure to designate a flow rate for its claims at Ennis Dam suggests that it may not have specified flow rates for water rights elsewhere. If so, what flow rates does MPC assert it is entitled to receive elsewhere?

Answer. MPC has claimed flow rates for all its other dams. These rates are summarized in Table 1 and are detailed in attachment 1. MPC did not define volumes for its Madison or Hebgen claims. In claim W094371, MPC indicated that storage occurs as early as March and as late as early July, but predominantly in April through June. In its "Objection to Temporary Preliminary Decree" for these rights in Basin 41F (Madison River), MPC has begun to develop an argument where the reservoirs, especially those with generation facilities, are drafted and filled to optimize generation capacity and to optimize hydraulic head.

7. MPC's claims fall into two broad categories. The first are claims for direct flows for power generation. The second category are claims for storage of water in reservoirs. This water is released for power generation. When water is in short supply, should MPC be required to release water from its reservoirs first, rather have any right to insist on direct stream flow water rights if it has sufficient water in its reservoirs to generate electrical power?

Answer. Most of MPC's facilities are operated as based-load and run-of-the-river facilities. FERC directs the operation of these facilities through its licensing process. MPC's only major storage reservoir is Hebgen. Holter and Hauser reservoirs only store about a week of the average Missouri River flow each. Most of the reservoirs, such as Holter and Hauser, are kept full to satisfy the recreational and other environmental needs and to maintain the hydraulic head for power generation.

A logical argument is that MPC should have to utilize its storage prior to calling junior water users. However, no mechanism exists to require this.

8. What is the maximum number of kilowatt hours generated at each of MPC's hydroelectric facilities prior to July 1, 1973?

Answer. Table 2 provides an estimate of power generation capacity for each dam. The maximum number of kilowatt hours generated at each of its facilities should be tied to the priority date. Priority dates for the MPC dams are generally prior to 1973. It should be noted that MPC's generation capacity has increased with the construction and operation of Canyon Ferry Reservoir and it pays headwater benefits for this additional generation capacity.

Table 2. MPC's estimated power generation capacity at each of its dams.

Dam	Capacity (kW)
Hebgen	0
Madison	9,000
Hauser	16,500
Holter	40,000
Black Eagle	18,000
Rainbow	35,000
Cochrane	50,000
Ryan	60,000
Morony	47,000
Mystic	11,500
Kerr	180,000
Thompson Falls	40,000
Milltown	3,200

Additional analysis would be needed to validate these claimed capacities.

9. How much water does MPC need either in the form of direct stream flows or storage, to maintain its pre-1973 levels of powers generation?

Answer. MPC needs most of the existing flow of the Missouri River to maintain its pre-1973 level of hydropower production on that system. MPC's claimed turbine capacity for Cochrane Dam at Great Falls is 10,000 cfs. Over 90 percent of the time, flows in the Missouri River are less than this rate. On the Clark Fork and Flathead rivers, MPC would need a large portion of the flow. For example, during the late summer MPC is generally passing the entire flow of the Flathead River through its turbines at Kerr Dam and the entire Clark Fork River through its turbines at the Thompson Falls Dam.

10. Has MPC increased power generation at its hydroelectric facilities since 1973? If so, how much additional water has MPC diverted to sustain its increased level of power generation?

Yes. For example, MPC increased its turbine capacity at Thompson Falls by 12,300 cfs and 8,904,186 acre-feet per year in May 1992. MPC obtained a FERC license for this additional

generation capacity in 1990 and then it used this information to obtain a new provisional water right from DNRC in 1992.

11. Are flow rates for MPC rights based on past hydropower generation, or are they based on the theoretical or potential maximum capacity of its generating facilities?

Answer. MPC claimed flow rates appear to be based on maximum turbine capacities at each facility or on affidavits of use rather than on historical hydropower generation at each facility.

12. Can MPC's successors-in-interest increase power generation and remain within the confines of MPC's existing water rights? Arguably, any increase in power generation over pre-1973 levels constitutes an unlawful expansion of MPC's water rights.

Answer. Yes. MPC's successors-in-interest can increase turbine efficiency as long as they do not increase their historical use of water. MPC cannot add new turbines without obtaining new water rights if the new turbines would increase their historical use of water. As noted in answer 10, when MPC added additional turbines at Thompson Falls on the Clark Fork River in 1992, it obtained a new water use permit from DNRC.

13. How will recreational usage of MPC's storage reservoirs be affected by a change in ownership of those reservoirs? MPC asserts that no changes will occur, but what specific guarantees support this assertion?

Answer. Recreational usage of MPC's storage reservoirs should not change as most of the issues associated with recreation should be defined by FERC in MPC's federal license. If anything, recreational usage will increase because of proposed FERC license conditions that increase access to various reservoirs. DEQ or DFWP may be able to give more details on this. Any new owner will be bound by the same FERC license conditions.

14. Montana law on the extent and scope of storage rights is ambiguous. Some case law says an operator of a reservoir is only entitled to enough water to fill its reservoir once during any calendar year. Other case law can be read to support a reservoir operator's right to more than one fill. How extensive are MPC's rights to storage water?

Answer. Historical use of water is always the key to a water right's extent. While water law in regard to storage does have ambiguities, the best view would be that where only one fill has been historically used, that would be the extent of the storage right. Where documented fill and refill is the historical use of a water right, however, that would describe the extent of a water right. Some states, such as Wyoming, follow the one-fill rule for administrative ease, while other states argue the one-fill rule does not make sense because it just means that more reservoirs will have to be built to achieve the same result as refilling one reservoir, resulting in greater waste. DNRC has not supported the one-fill rule for that reason.

15. Can MPC be compelled to release water from storage when that water is not necessary for power generation and downstream water users are suffering from a shortage?

Answer. No, not if the downstream users are junior to MPC, and MPC is beneficially using water as it historically has within its claimed water rights.

16. Would MPC be willing to make protection of other water users a component of its sale of its hydropower generating facilities?

Answer. Apparently not. See the February 20, 1998, letter from MPC to Governor Racicot (attachment 2). Additionally, at a meeting at the Twin Silos near Townsend that MPC attended this spring, Mike Zimmerman, Vice President of MPC, reiterated that MPC would do everything necessary to protect its water rights.

17. MPC says its rights are non-consumptive. It argues that exercise of its non-consumptive rights diminish impacts to other users. Can it place a call on junior users and force them to discontinue using their right to provide an improved supply for MPC?

Answer. DNRC is not aware of an argument made by MPC that its non-consumptive rights diminish impacts to other users. Yes, MPC can call water users and force them to discontinue using their water rights if those water users have junior water rights and MPC's senior water right is not being satisfied (and as long as MPC does not exceed its historical use). That is the nature and basis of the prior appropriation doctrine in the West.

Even though MPC's water rights are non-consumptive, the effects of an MPC call on upstream junior water users would be the same as if MPC's water rights were consumptive use rights.

18. How will water use patterns change if MPC sells its hydroelectric facilities and related water rights to different buyers? At present, MPC can make up for shortages at some of its facilities by releasing excess water from other facilities upstream. This flexibility will be lost if MPC's water rights are sold to multiple new owners.

Answer. The operations may change very little. The FERC licenses restrict the operational choices, regardless of who owns the dams. MPC generally releases stored water from Hebgen during the winter and these releases benefit hydropower production at all facilities downstream. The new owners of the downstream facilities may want to negotiate a payment plan with the new Hebgen owners. Of course, if Hebgen came under new ownership, releases from it would still be restricted by the FERC license. There is a week or so of storage each in the Holter and Hauser pools, but to maximize head and subsequent power generation, it would generally be to the owners advantage to keep the level of these reservoirs as high as possible. Again, the FERC license would restrict the new owner's ability to make major operational changes. We do not know how the collection of "headwater benefits" for Canyon Ferry storage would be worked out when ownership changes. The new owners may have to re-negotiate payment for these with the

Bureau of Reclamation, the operator of Canyon Ferry. Another question is whether the Bureau of Reclamation could make the new owners pay for these benefits, because its operations of Canyon Ferry are pretty well set. And, on the same note, would there really be any incentive for new owners to pay for Hebgen releases?

Regarding the FERC relicensing, many of the commitments MPC is making are financial. For instance, in the FERC Missouri/Madison hydroelectric project draft EIS, it is proposed that MPC would fund waterfowl and fisheries studies on the Madison/Missouri. If each dam were bought by a different party, FERC would have to decide who pays for these studies and how much? There are many recommendations made in the draft EIS that would be difficult to implement unless all of the dams were owned by one party. Apparently, it would be up to FERC to insure that all the requirements of the federal hydropower license are met by the new owner(s).

MPC has apparently proposed to operate the Great Falls dams in a manner that would allow peaking within the group, using Morony storage to smooth out the daily fluctuations at the downstream end. This kind of coordination may be difficult if there were multiple owners of this group of dams.

19. What are the priority dates of MPC water rights in comparison to other right holders?

Answer. Please refer to Table 1 and Attachment 3. MPC holds reasonably senior water rights within the Missouri and Clark Fork Basin.

20. If energy production becomes more efficient, requiring less water, can MPC be compelled to divert less or hold less in storage when other users are suffering shortages?

Answer. See again the answer to 12. In the event of MPC's becoming more efficient using the same number of turbines and the same amount of water within its historical water rights, no new permit or change authorization would be needed from DNRC even though more electricity was being produced.

21. Since instream flow is now a recognized beneficial use, how will MPC diversions and storage affect holders who opt for instream flow, especially where MPC has unquantified or exaggerated flow rates?

Answer. The priority system dictates that whoever comes onto the stream after MPC, whether their use is instream flow or consumptive, are subject to a call by MPC based on its senior water rights.

basin	ld	wr #	ext	use	ld	rate	unit	volume	priority	qtr	sec	hwp	mng	trib	source	owner	Project Name
41D	W	094381	00	PG	F	1200.00	C	876000.00	18970802	W2W2SE	11	01S10W			BIG HOLE RIVER	MONTANA POWER CO	Big Hole
41D	W	094383	00	PG	F	645.00	C	0.00	18970802	W2W2SE	11	01S10W			BIG HOLE RIVER	MONTANA POWER CO	Big Hole
41D	W	094382	00	PG	F	50.00	C	36500.00	18970812	W2W2SE	11	01S10W			BIG HOLE RIVER	MONTANA POWER CO	Big Hole
41D	W	094384	00	PG	D	250.00	C	0.00	18971201	SWNESW	10	02S12W			PATTENGAIL CREEK	MONTANA POWER CO	Big Hole
41F	W	094375	00	PG	F			1127120.00	18950824	SWNWSW	20	04S01E			MADISON RIVER	MONTANA POWER CO	Madison
41F	W	094376	00	PG	F			0.00	18950824	SWNWSW	20	04S01E			MADISON RIVER	MONTANA POWER CO	Madison
41F	W	094371	00	PG	F	2000.00	C	0.00	19060430	NE	22	11S03E			MADISON RIVER	MONTANA POWER CO	Hebgen
41F	W	094372	00	PG	F	6000.00	C	0.00	19060529	NE	22	11S03E			MADISON RIVER	MONTANA POWER CO	Hebgen
41F	W	094373	00	PG	U	99999.99	C	0.00	19140601	NE	22	11S03E			MADISON RIVER	MONTANA POWER CO	Hebgen
41I	W	094385	00	SG	U			47500.00	18981031	NWSESE	4	10N01W			MISSOURI RIVER	MONTANA POWER CO	Old Cany. Ferry
41I	W	094386	00	PG	F	4740.00	C	3493000.00	19050623	E2SW	29	12N02W			MISSOURI RIVER	MONTANA POWER CO	Hauser
41I	W	094387	00	PG	F	3380.00	C	0.00	19050623	N2SESW	29	12N02W			MISSOURI RIVER	MONTANA POWER CO	Hauser
41I	W	094388	00	PG	F	8120.00	C	0.00	19060825	N2SESW	29	12N02W			MISSOURI RIVER	MONTANA POWER CO	Hauser
41I	W	094389	00	PG	F	3000.00	C	0.00	19060827	N2SESW	29	12N02W			MISSOURI RIVER	MONTANA POWER CO	Hauser
41I	W	094390	00	PG	U	19100.00	C	0.00	19070228	N2SESW	29	12N02W			MISSOURI RIVER	MONTANA POWER CO	Hauser
41I	W	094348	00	PG	U	7100.00	C	5183000.00	19180430	NWNE	8	14N03W			MISSOURI RIVER	MONTANA POWER CO	Holter
41I	W	094349	00	PG	U	41300.00	C	0.00	19180430	NWNE	8	14N03W			MISSOURI RIVER	MONTANA POWER CO	Holter
41Q	W	094354	00	PG	U	3300.00	C	2409000.00	18920601		5	20N04E			MISSOURI RIVER	MONTANA POWER CO	Black Eagle
41Q	W	094355	00	PG	U	900.00	C	857000.00	18931231		5	20N04E			MISSOURI RIVER	MONTANA POWER CO	Black Eagle
41Q	W	094358	00	PG	F	3500.00	C	2555000.00	19080916		34	21N04E			MISSOURI RIVER	MONTANA POWER CO	Rainbow Dam
41Q	W	094362	00		F	532.00	C	0.00	19080916		34	21N04E			MISSOURI RIVER	MONTANA POWER CO	Rainbow Dam
41Q	W	094359	00	PG	U	280.00	C	204400.00	19121231		5	20N04E			MISSOURI RIVER	MONTANA POWER CO	Black Eagle
41Q	W	094367	00	PG	U	5900.00	C	4307000.00	19150831		17	21N05E			MISSOURI RIVER	MONTANA POWER CO	Ryan
41Q	W	094368	00		U	1407.00	C	0.00	19150831		17	21N05E			MISSOURI RIVER	MONTANA POWER CO	Ryan
41Q	W	094360	00	PG	U	1640.00	C	1197200.00	19170701		34	21N04E			MISSOURI RIVER	MONTANA POWER CO	Rainbow
41Q	W	094356	00	PG	U	560.00	C	408800.00	19270831		5	20N04E			MISSOURI RIVER	MONTANA POWER CO	Black Eagle
41Q	W	094357	00		U	862.00	C	0.00	19270831		5	20N04E			MISSOURI RIVER	MONTANA POWER CO	Black Eagle
41Q	W	094396	00	PG	F	8280.00	C	6044400.00	19281220		14	21N05E			MISSOURI RIVER	MONTANA POWER CO	Morony Dam
41Q	W	094397	00		F	3981.00	C	0.00	19281220		14	21N05E			MISSOURI RIVER	MONTANA POWER CO	Morony Dam
41Q	W	094365	00	PG	F	10000.00	C	7300000.00	19550616	SWSW	19	21N05E			MISSOURI RIVER	MONTANA POWER CO	Cochrane Dam
41Q	W	094366	00		F	2961.00	C	0.00	19550616	SWSW	19	21N05E			MISSOURI RIVER	MONTANA POWER CO	Cochrane Dam
41Q	W	094361	00	PG	U	480.00	C	292000.00	19580326		34	21N04E			MISSOURI RIVER	MONTANA POWER CO	Rainbow
43C	W	094417	00	PG	F	169.00	C	0.00	19160825	SWSE	9	07S16E			WEST ROSEBUD CREEK	MONTANA POWER CO	Mystic lake
43C	W	094418	00	SG	F			71856.00	19160825	SWSE	9	07S16E			WEST ROSEBUD CREEK	MONTANA POWER CO	Mystic Lake
76L	W	094408	00	PG	F	14540.00	C	814200.00	19200403	SESW	12	22N21W			FLATHEAD RIVER	MONTANA POWER CO	Kerr Dam
76L	W	094409	00	SG	F	99999.99	C	0.00	19200403	SESW	12	22N21W			FLATHEAD RIVER	MONTANA POWER CO	Kerr Dam
76L	W	094412	00	PG	F	35000.00	C	0.00	19601202	SESE	1	21N22W			FLATHEAD RIVER	MONTANA POWER CO	Buffalo Rapids
76L	W	094413	00	PG	F	35000.00	C	0.00	19601202	S2N2	1	19N22W			FLATHEAD RIVER	MONTANA POWER CO	Buffalo Rapids
76M	W	094404	00	PG	F	2000.00	C	1451556.00	19041211	SENE	20	13N18W			CLARK FORK RIVER	MONTANA POWER CO	Milltown Dam
76M	W	094405	00		F			0.00	19041211	SENE	20	13N18W			CLARK FORK RIVER	MONTANA POWER CO	Milltown Dam
76N	W	094414	00	PG	D	1250.00	C	904958.18	19050331	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	094415	00	PG	D	1250.00	C	0.00	19050331	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	211938	00	PG	D	2000.00	C	1447833.10	19060129	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	211941	00	PG	D	2000.00	C	0.00	19060129	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	211939	00	PG	D	5000.00	C	3619632.75	19061203	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	211942	00	PG	D	4297.00	C	0.00	19061203	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	W	211940	00	PG	D	2870.00	C	2077783.99	19060629	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls
76N	P	081517	00	PG	0	12300.00	C	8904186.00	19920513	NWSW	8	21N29W			CLARK FORK RIVER	MONTANA POWER CO	Thompson Falls





GENERAL OFFICES: 40 EAST BROADWAY, BUTTE, MONTANA 59701-9394

MONTANA POWER COMPANY

LEGAL DEPARTMENT

MICHAEL E. ZIMMERMAN
VICE PRESIDENT & GENERAL COUNSEL
PATRICK T. FLEMING
MICHAEL P. MANION
MARJORIE L. THOMAS

SUSAN CALLAGHAN
W. WAYNE HARPER
BRIAN HOLLAND
MICHAEL V. HARRINGTON

February 20, 1998

Governor Marc Racicot
Room 204 State Capital
Helena, MT 59620

Dear Governor Racicot:

Recently, you received letters from the Montana Farm Bureau Federation and from Mr. Larry Holman regarding their concerns about impacts on the agriculture industry if either MPC or a new owner were to enforce its senior water rights against junior agriculture water rights. Mr. Holman's letter was a copy of his request to the Federal Energy Regulatory Commission ("FERC") to subordinate MPC's senior water rights to those of the Montana Department of Natural Resources ("DNRC") Broadwater-Missouri irrigation project. By this letter, MPC is providing you our preliminary thoughts on this issue.

The concerns expressed by Mr. Holman and the Farm Bureau are not new concerns. During the agency consultation process required for FERC licensing, the DNRC raised the very concerns expressed by Mr. Holman and the Farm Bureau. Enclosed is a 1991 letter from the DNRC requesting MPC to analyze the impacts on agriculture if MPC were to curtail junior water users. Also enclosed are portions of MPC's Draft and Final Project 2188 License Application that responded to DNRC's request.

From MPC's perspective, if, after MPC provided the analysis requested by DNRC, DNRC had any concerns about the analysis results, DNRC would have raised the issue and there would have been discussions to resolve the concerns. However, DNRC never submitted any comments to FERC on MPC's analysis of the impacts on agriculture that may result if MPC were to curtail junior users. Importantly, DNRC never suggested that it was important to place in the new license a condition that, in effect, subordinates MPC's vested senior water rights to junior water rights. As well, neither the DNRC nor any member of the public provided any comments to FERC on this issue during the public meetings FERC held in Montana to receive comments on MPC's license application.

Because of MPC's proposed sale of its generating facilities, the issue of "what if" MPC curtailed junior water users has been revived, primarily, we understand, because of

fear that a new owner may choose to exercise the acquired MPC water rights in circumstances in which, it is presumed, MPC would not. To address this issue, DNRC has submitted comments to the FERC Draft EIS that, in effect, suggests that FERC subordinate MPC's senior water rights to junior water rights. DNRC suggests that because MPC has never curtailed junior water users, junior water users have come to rely on this "practice" and therefore that "practice" should be made a permanent feature of project operations. In other words, the DNRC has asked FERC to consider a mere possibility as an impact of project operations. There is no demonstrated harm.

DNRC is asking FERC to circumvent state water law. By arguing the junior water users are entitled to the status quo, DNRC appears to be trying to accomplish through the FERC licensing process what cannot be accomplished through state water law. While MPC recognizes that FERC may have the authority in certain circumstances to impose water rights subordination conditions in new project licenses, MPC does not believe that FERC has the authority to subordinate vested water rights to junior water rights and thus impair the state-created water right, which is a property right. The mitigation or subordination condition suggested by DNRC would have the effect of interfering with a vested right acquired under state law. Such a condition constitutes a taking of MPC's water rights because the condition would impair an essential feature of the right. MPC will not agree to subordinate its water rights.

Throughout the licensing process MPC has worked in good faith with the agencies and the public to address concerns arising out of operation of our dams. MPC is disappointed that the DNRC has chosen to respond in this fashion to concerns raised by the sale of MPC's dams, when that issue had been addressed previously to DNRC's apparent satisfaction. The issue now is no different than it was three years ago. It is a state water rights issue.

In addition, DNRC's suggestion appears to be inconsistent with license condition requests of other state agencies such as the Montana Department of Fish & Game and the Department of Environmental Quality. In essence, these agencies want FERC to impose conditions that require keeping water as much water in the river as possible. The DNRC's position also conflicts with previous arguments of state agencies to the effect that water use issues, water quality issues, and water rights issues are the state's province and FERC should not interfere with state decisions or make decisions for the state.

We hope that the information contained in this letter has been helpful in your understanding of this issue.

Sincerely, ,



Michael E. Zimmerman
Vice President and General Counsel

DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION

STAN STEPHENS, GOVERNOR

LEE METCALF BUILDING
1520 EAST SIXTH AVENUE



STATE OF MONTANA

DIRECTOR'S OFFICE (406) 444-6699
TELEFAX NUMBER (406) 444-6721

HELENA, MONTANA 59620-2301

November 22, 1991

Michael Zimmerman
General Counsel
Montana Power Company
40 E. Broadway
Butte, MT 59701

Dear Mike:

I am writing as a follow up to the November 12, 1991 consultation meeting held in Butte concerning Montana Power Company's proposed application for a new license for its nine hydroelectric developments on the Missouri and Madison Rivers.

At the meeting the Department made inquiry regarding information on junior water users. The concern expresses the need for Montana Power Company to address the impact that might arise if a new license is granted and in order to protect its property interests and water interests Montana Power Company exercises its right to make a call on the river as to any or all junior water uses. This concern was raised as the fourth of the Water Resources Division's comments found on pages 16 and 17 of the September 29, 1989, "State of Montana's Comments To The Montana Power Company's Proposed Studies For The Relicensing Of FERC Project No. 2188". The comment was raised on page 17 and stated:

Because a significant number of junior users have been using water from the Missouri River for the last 50 or more years without ever being called by MPC they have relied on that water for their very livelihoods and any change in the status quo could significantly impact them. For that reason it is imperative to have information of the number of people who are junior, the amount of lands irrigated and the amount of water involved.

As the comment expresses, the reason for addressing this impact is because Montana Power Company has historically never exercised its right to make a call under the existing license. As a result there are many existing and viable economic units with junior water rights to those of Montana Power Company that have an expectation that their junior rights will never be called on to satisfy the senior water rights of Montana Power Company.

CENTRALIZED SERVICES
DIVISION
(406) 444-6700

CONSERVATION & RESOURCE
DEVELOPMENT DIVISION
(406) 444-6667

ENERGY
DIVISION
(406) 444-6677

OIL AND GAS
DIVISION
(406) 444-6675

WATER RESOURCES
DIVISION
(406) 444-6661

The Department is not taking a position that any junior water right holder has a legal right to such an expectation or that any past action of Montana Power Company has waived its right to make a call on the river in the future. Since 1989 the Department has been attempting to identify this concern in the consultation process to allow Montana Power Company to appropriately address what the impacts will be to junior water right holders in the event a new license is issued and it becomes necessary for Montana Power Company to assert its rights.

The Department believes that by complying with the procedural and substantive state water laws Montana Power Company can protect its property, including its water rights. The Department believes that Montana Power Company as a senior water right holder has the right to exercise all rights and privileges associated with its water rights. However, the federal licensing process is not controlled by this or any other state agency. The federal process requires a full understanding of the impacts associated with the licensing of nine hydroelectric developments on the Missouri and Madison Rivers in Montana. The effect on the economic interests of junior water users of making a call on the river two out of ten years to fully satisfy the senior water rights of Montana Power Company is an impact that the federal decision-makers must be aware of in carrying out their statutory responsibilities. The purpose of the Department's inquiry in the consultation process is to have Montana Power Company address the associated impacts of enforcing existing senior water rights when enforcement has not historically occurred.

If I can help clarify the matter further please do not hesitate to contact me.

Sincerely,



Donald D. MacIntyre
Chief Legal Counsel

c: Barclay
Jamison
Fritz
Hall
Mary Gail Sullivan

1.5.3 Socioeconomic Impacts

The Applicant proposes no physical modifications to the Hebgen Development. Ongoing operation of the Development, as described in *Exhibit B, Section 1.3*, has a positive economic impact on Gallatin County. The economic benefits from recreation associated with the Development are described in Section 1.7.4 "Recreational Use" on page E-1-92. An additional benefit to the county is the tax revenues the Applicant pays. In 1990, the Applicant paid \$49,005 to Gallatin County in property taxes for the Hebgen Development.

Agency Comments

Note: This section applies to all nine developments.

By letters dated November 22, 1991, and September 29, 1989, to Mike Manion, attorney for the Applicant, the DNRC asked the Applicant to assess the impact of the Applicant exercising its right to enforce its senior water rights against holders of junior water rights. Since the late 1940s, the Applicant has not sought this enforcement. Even though the Applicant has not exercised its senior water rights, it has not waived its right to exercise the rights and privileges associated with its status as a senior water right holder.

The process through which the Applicant would seek enforcement of its rights is difficult to predict. Further, except perhaps, during periods of extreme drought, there is sufficient water available to accommodate operation of the Project as set forth in this Application, without curtailing junior water rights. Thus, any enforcement action, such as the DNRC questioned, would not be taken without a thorough analysis of the many economic, environmental, legal, and political factors which would influence the decision.

In response to the DNRC's request, a general assessment of the economic impact of exercising this right was undertaken. In completing the assessment, no assumptions were made concerning specific water rights. Also, the estimates were computed using a number of assumptions and simplifications and may not be precise.

Agriculture accounts for the majority of the consumptive water use in the Missouri River Basin. Consequently, agricultural interests would represent most of the junior water users that might be impacted by the Applicant exercising its senior water rights.

Figure 1.5.3-1 is a plot of historic irrigated areas above Morony Dam from 1928 to 1986 taken from the acreage files of the DNRC's Missouri River Model. With the exceptions of the dips in the mid 1940s (WWII ?) and the mid 1970s (farm economics?), the irrigated acres should be a rough indication of the historic irrigation water rights junior to the Applicant's water rights. Some inferences of economic impact can be made by using historic irrigated area values.

For the purposes of the model, the DNRC divided the Basin into subbasins (see Figure 1.5.3-2). The Missouri-Madison Project would affect agriculture, if at all, only in the Headwaters and Upper Missouri subbasins above Morony Dam. Alternative impact estimates were computed for these two subbasins corresponding to various dates for establishing the senior water rights. Morony Dam was completed in 1930; Canyon Ferry Dam was completed in 1954; Cochrane Dam entered production in 1958. In addition, 1974 and 1978 were benchmark years when surveys of irrigated agricultural acreage were completed

Figure 1.5.3-1

HISTORICAL IRRIGATED ACRES ABOVE MORONY

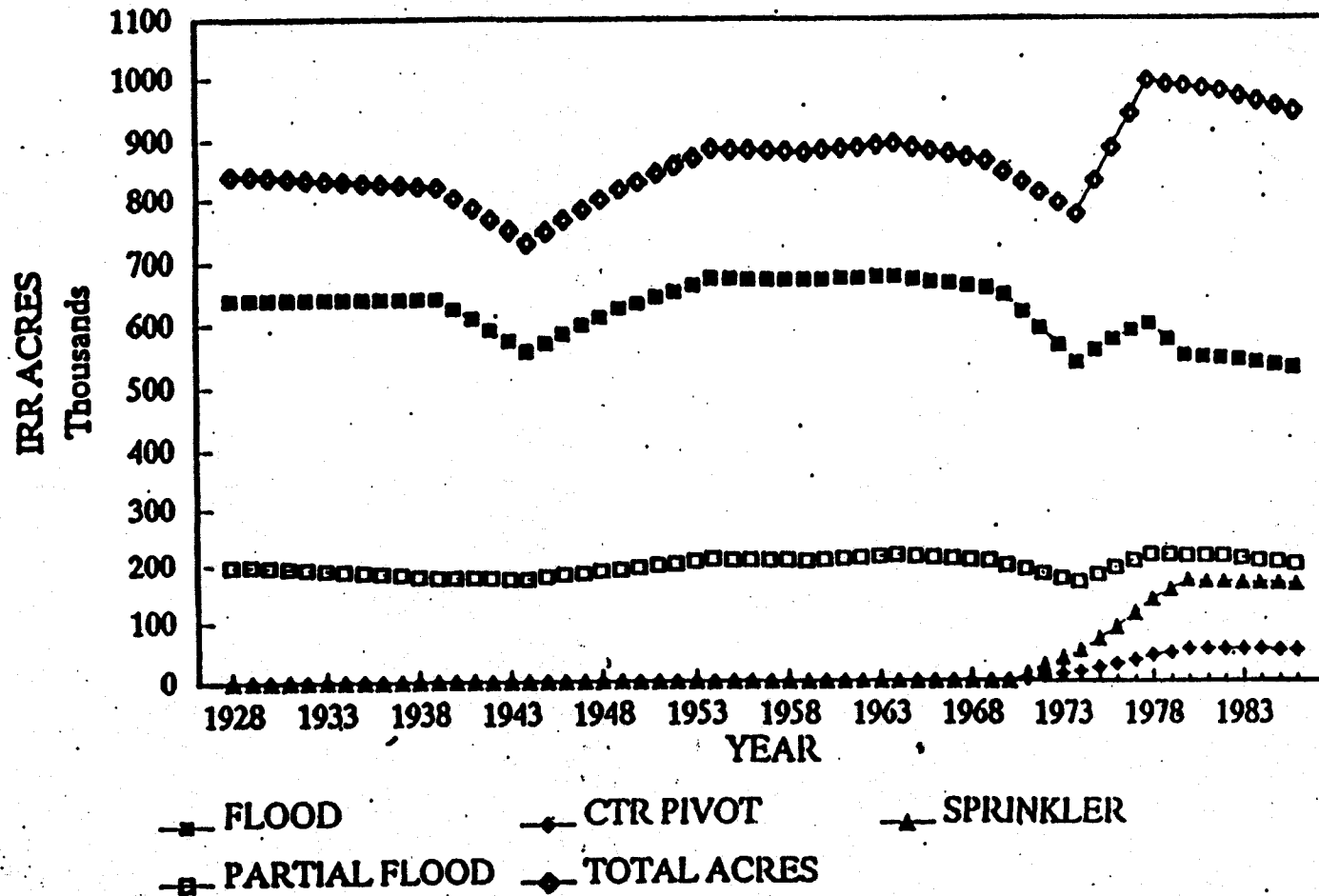
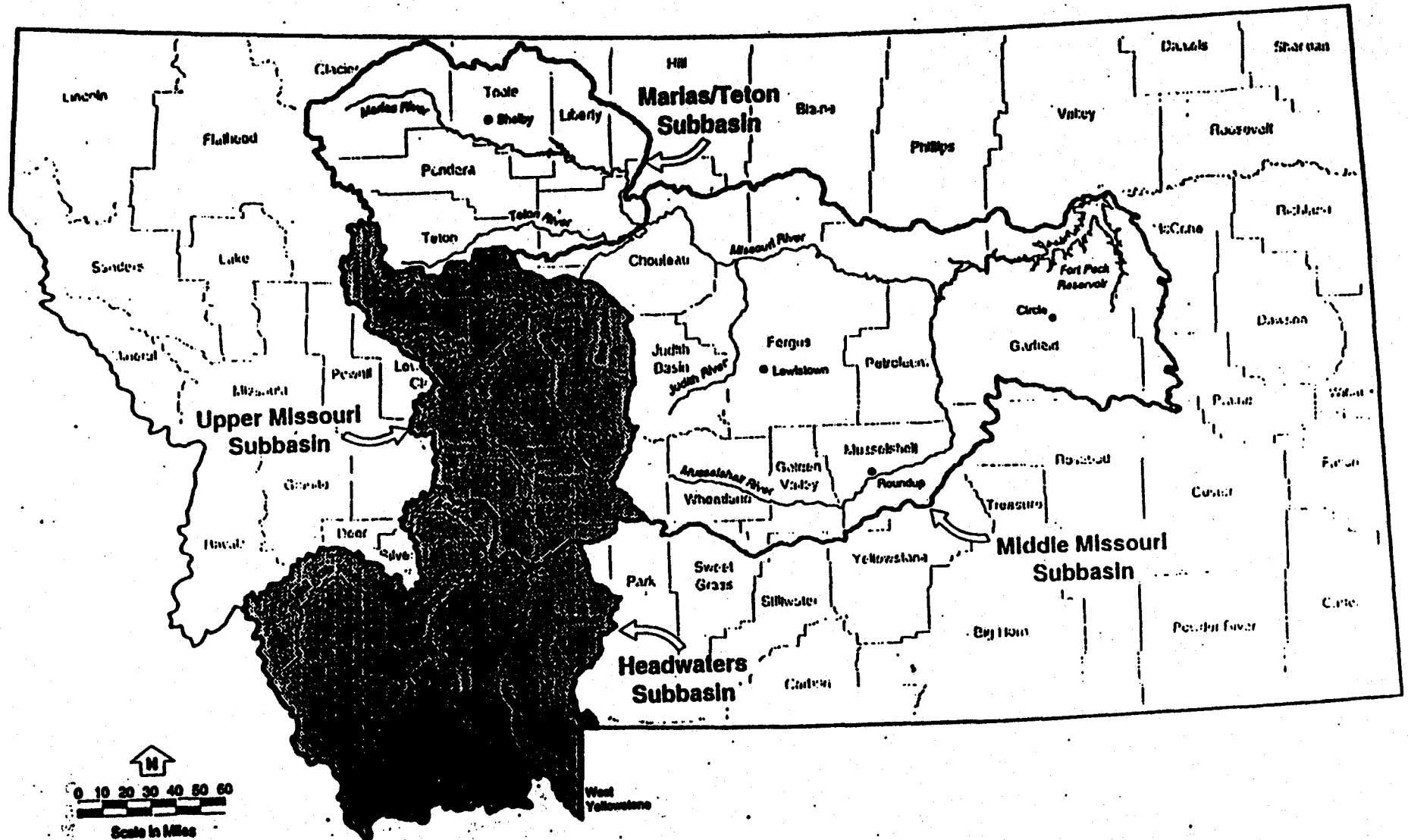


Figure 1.5.3-2 Missouri River Subbasins



Source: DNRC, 1991

The changes in agricultural sales associated with the increment in irrigated acres were estimated using DNRC's methodology to determine the economic impact of new water reservations. Specifically, the change in agricultural sales is due to the land now growing a nonirrigated crop rather than a higher value irrigated crop. Separate computations were made for each county in the subbasins, using the specific parameters derived by DNRC for that county. DNRC's explanation for its methodology is as follows:

The change in total agricultural sales is estimated using the value of alfalfa raised on the irrigated land less the equivalent crop of dryland crops (barley) rotated every two years. An eight year time frame is used to account for rotating alfalfa and barley on irrigated acreage.

Finally, the changes agricultural sales were converted to changes in agricultural labor income based on the historic ratio (1984-1989) between them in each subbasin. To put things in perspective, the changes in agricultural labor income were compared to average agriculture labor income and total labor income in the basic industries in the subbasin.

Table 1.5.3-1 is a summary of the estimated economic impact that might occur as a result of a change in irrigated acreage. The estimated changes in irrigated acreage is the change required to adjust the 1986 irrigated acreage to the acreage in the identified earlier year. A negative number indicates an enforcement action would be necessary to reduce the irrigated acreage by the number shown. A positive number means that the number of irrigated acres was larger in the earlier year than during 1986 suggesting that no enforcement action would be necessary.

In the Headwaters Subbasin, the greatest negative economic impacts would occur if the Applicant enforced its senior rights to reduce the irrigation depletions to 1974 levels. As shown in Table 1.5.3-1, irrigated land would decrease by 118,325 acres, or 17.7%. Agricultural sales would decline about \$16,922,000 per year. The corresponding decline in farm labor income is approximately \$2,758,000 per year, which represents about 16.8% of the average farm labor income during the 1984-1989 period. The estimated decrease in farm labor income represents about 1.3% of the economic base in the Headwaters Subbasin.

In the Upper Missouri Subbasin, the greatest negative impact would occur if the Applicant exercised its rights to reduce the irrigation depletions to the 1930 level. In this case, irrigated acres would decrease by 104,387, or 38.9%. Agricultural sales would drop approximately \$19,425,000 per year, and farm labor income would decline roughly \$3,380,000 per year. The decrease in farm labor income represents about 14.8% of the 1984-1989 average and slightly less than 1% (0.9%) of the economic base in the Upper Missouri Subbasin.

A more precise estimate of local economic impact is almost impossible to derive because it depends not only on the exact water rights called, but also the acreage that the water right owner chooses not to irrigate, the crops grown, crops grown at the time, and other factors.

Table 1.5.3-1
Estimated Economic Impacts of Changes in
Irrigated Acres

	<u>Historic Irrigated Acres</u>				
	<u>1930</u>	<u>1954</u>	<u>1958</u>	<u>1974</u>	<u>1978</u>
<u>Headwaters Subbasin (Node 1 to 12)</u>					
Change in Irrigated Acres	2,860	-363	-15,980	-118,329	48,730
Percent of 1986 Irrigated Acres	0.4	0.1	2.4	17.7	7.3
Change in Agricultural Sales (\$000)	\$0	\$-144	\$-2,344	\$-16,922	\$0
Change in Agricultural Labor Income (\$000)	\$0	\$-23	\$-382	\$-2,758	\$0
Percent of 84-89 Average Ag. Labor Income	0	0.1	2.3	16.8	0
Percent of 84-89 Average Basic Labor Income	0	0.1	0.2	1.3	0
<u>Upper Missouri Subbasin (Node 13 to 23)*</u>					
Change in Irrigated Acres	-104,387	-59,620	-47,707	-51,515	2,472
Percent of 1986 Irrigated Acres	38.9	22.3	17.8	19.2	0.9
Change in Agricultural Sales (\$000)	\$-19,425	\$-10,497	\$-9,346	\$-935	\$0
Change in Agricultural Labor Income (\$000)	\$-3,380	\$-1,827	\$-1,468	\$-1,624	\$0
Percent of 84-89 Average Ag. Labor Income	14.8	8.0	6.4	7.1	0
Percent of 84-89 Average Basic Labor Income	0.9	0.8	0.4	0.4	0

*Acreage reductions were computed from 1986 level above Morony Dam.

1.6 Report on Geological and Soil Resources

The geological and soil resources of the Hebgen Development are characteristic of the alluvium filled river valleys associated with the rugged mountainous terrain of the northern Rocky Mountains.

A soil resource investigation for the Hebgen Development was completed for The Montana Power Company by the consulting firm of Stensatter, Druyrenstein, and Associates. A summary of their findings is included in Section 1.6.2 "Description of Soils" on page E-1-55 and those sections of 1.6.3 "Geologic and Soils Hazards" on page E-1-71 which address soil resources.

1.6.1 Description of Geological Features

Regional Geology: Hebgen Dam is located at the upper end of the Madison River Canyon in the southern part of the Madison Range, about 10 miles west of Yellowstone National Park. This is an area of rugged topography with very steep-sided canyon walls.

The region is comprised of Precambrian igneous and metamorphic basement rocks. In some areas, Paleozoic and Mesozoic sedimentary rocks cover the basement rocks. The Madison Valley, through which the Madison River runs, was formed when a block of

streamflow data needed to run the model is 1928. I ran the model for six scenarios which are summarized in Table 2.

Of these, Scenario 2 best represents baseline conditions because it is the earliest year and does not include Canyon Ferry Dam--which did not begin operations until 1953. Scenario 5 represents existing conditions because it includes Canyon Ferry operations and is a recent year during which irrigation development was near its peak. Scenarios 3 and 4 were included because 1955 is the year that Canyon Ferry Reservoir first reached operational levels.

Table 2. Scenarios modeled to investigate the effects of irrigation development on MPC hydropower production on the Missouri River.

1	1928	yes
2	1928	no
3	1955	yes
4	1955	no
5	1986	yes
6	1986	no

Model results for the six scenarios are presented in Table 3. These figures are the total modeled hydropower production in Gigawatt hours (GWhr) for the seven MPC mainstem Missouri dams. They are summarized as monthly and annual average and percentile values.

Discussion

Modeled average annual hydropower production under existing conditions (Scenario 5: 1,974 GWhr) is slightly higher than that under 1928 conditions (Scenario 2: 1,911 GWhr). But more noticeable than average annual changes, is the way Canyon Ferry operations have change seasonal hydropower production (Figure 1). High spring and early summer flows are captured and stored in Canyon Ferry, resulting in generally reduced power production during this time. This stored water is generally released from Canyon Ferry Reservoir during the late summer and winter, which has increased power production during these seasons. Importantly, the net effect of Canyon Ferry Reservoir on MPC hydropower production has been positive. This is because some of the high flows that are stored in the reservoir, would otherwise spill over MPC dams and therefore produce no power. With the reservoir there, these flows are stored and then released later in the season after natural flows have dropped and when they can be fully used at the MPC dams. MPC is aware of these "headwaters benefits" and pays the U.S. Bureau of Reclamation for

Table 3. Total modeled energy production for MPC Missouri River dams (GWhr).

Scenario 1: 1928 Level of Irrigation Development with Canyon Ferry Reservoir Storage

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	153.5	145.8	176.1	179.0	196.5	192.6	177.7	147.1	142.2	167.3	159.2	164.7	2001
%	195.3	186.7	217.4	210.5	217.4	210.5	217.4	195.4	183.7	192.8	187.9	193.2	2355
%	189.7	173.3	210.3	208.1	217.4	210.5	208.5	182.4	174.7	187.9	181.6	187.0	2300
%	162.6	149.8	189.2	190.1	208.0	201.4	177.9	135.1	133.7	177.0	168.2	175.1	2038
%	117.3	111.9	126.9	155.6	175.5	171.8	147.4	122.3	115.3	141.7	136.0	147.8	1720
%	105.3	101.5	116.8	121.3	162.2	158.3	138.0	113.5	101.9	116.6	107.8	111.6	1469

Scenario 2: 1928 Level of Irrigation Development without Canyon Ferry Reservoir Storage

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	135.2	133.3	167.2	182.4	208.5	203.0	164.7	108.0	134.5	166.4	163.7	144.3	1911
%	173.1	168.3	197.2	210.5	217.4	210.5	217.4	172.6	182.6	205.0	192.9	172.4	2211
%	159.8	157.6	186.1	207.0	217.4	210.5	210.6	153.1	171.5	195.5	186.5	165.9	2157
%	136.0	138.7	171.0	188.3	217.4	210.5	177.4	100.0	128.5	174.7	166.0	147.5	1959
%	112.8	108.4	143.3	160.9	203.2	199.7	113.9	65.3	104.7	138.0	149.2	126.8	1631
%	103.0	88.4	134.1	143.3	184.6	185.1	78.5	50.9	83.1	127.5	127.0	103.5	1493

Scenario 3: 1955 Level of Irrigation Development with Canyon Ferry Reservoir Storage

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	154.7	145.6	176.6	179.2	195.9	190.5	170.2	146.4	142.4	168.2	160.0	165.9	1996
%	195.2	186.1	217.4	210.5	217.4	210.5	217.4	193.1	187.1	193.0	187.5	192.3	2350
%	189.5	173.0	212.5	208.5	217.4	210.5	213.6	180.6	174.3	187.7	181.7	186.6	2300
%	163.6	149.5	189.8	190.6	208.1	201.5	179.0	137.8	133.6	177.4	167.7	174.3	2035
%	119.8	112.0	127.1	156.3	173.9	170.5	127.3	115.5	116.1	149.0	136.6	148.1	1693
%	107.4	101.7	117.2	121.3	162.0	149.3	115.8	109.6	109.3	118.9	111.8	118.5	1480

Scenario 4: 1955 Level of Irrigation Development without Canyon Ferry Reservoir Storage

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	134.1	132.8	167.2	182.3	208.0	203.2	164.7	110.8	131.1	165.0	162.1	142.6	1903.0
%	172.1	167.9	197.0	210.5	217.4	210.5	217.4	170.0	181.3	204.3	191.7	171.0	2215.0
%	158.6	157.3	186.0	206.9	217.4	210.5	215.5	150.8	170.5	195.1	185.7	164.5	2156.0
%	135.1	138.2	170.6	188.2	217.4	210.5	181.1	106.8	128.4	173.3	164.0	145.8	1950.0
%	111.3	107.7	143.2	160.7	201.3	199.8	112.1	72.1	99.0	136.2	146.6	125.4	1631.0
%	102.1	87.5	133.6	142.9	184.6	184.3	87.5	55.2	80.3	125.1	124.6	101.4	1484.0

Scenario 5: 1986 Level of Irrigation Development with Canyon Ferry Reservoir Storage

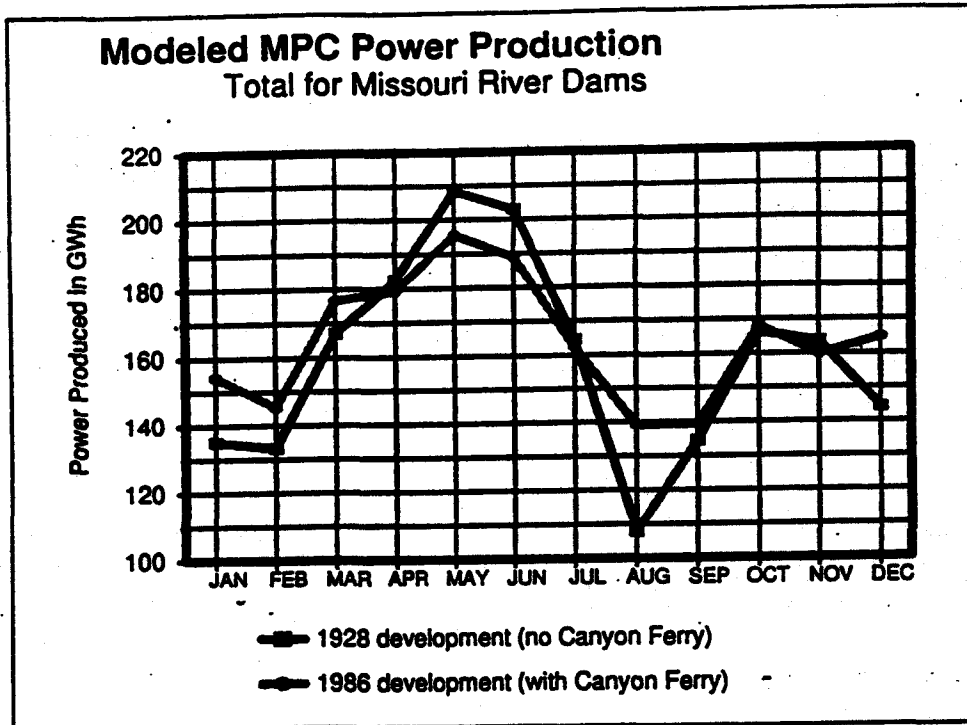
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	154.4	145.4	176.7	179.3	195.6	189.0	162.3	139.2	139.4	168.3	159.8	164.8	1974.0
%	195.6	186.3	217.4	210.5	217.4	210.5	217.4	189.7	186.2	193.5	187.9	192.4	2349.0
%	189.9	172.9	212.5	208.6	217.4	210.5	211.3	176.8	173.2	188.2	181.6	186.7	2290.0
%	163.9	149.8	190.0	191.3	208.1	201.3	172.8	124.3	128.1	177.6	168.0	174.7	2016.0
%	119.9	112.5	127.5	156.2	172.8	168.5	115.4	107.1	112.5	143.9	137.3	148.7	1669.0
%	107.9	99.8	117.5	121.6	161.4	143.2	103.9	101.3	105.3	119.9	109.4	116.3	1451.0

Scenario 6: 1986 Level of Irrigation Development without Canyon Ferry Reservoir Storage

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANN
Energy	135.0	133.5	167.6	182.8	208.0	202.1	154.3	99.8	129.1	164.4	162.5	143.4	1883.0
%	172.9	168.4	197.4	210.5	217.4	210.5	217.4	164.7	180.3	204.3	191.9	171.7	2199.0
%	159.6	157.8	186.5	207.1	217.4	210.5	214.2	141.0	170.3	194.8	186.0	165.2	2148.0
%	135.8	139.0	171.5	188.7	217.4	210.5	173.3	97.3	125.7	172.5	164.6	146.9	1920.0
%	112.5	108.6	143.7	161.4	200.7	196.6	84.6	52.8	98.0	135.4	146.7	126.3	1593.0
%	101.9	88.7	134.6	144.1	184.8	180.9	64.4	42.4	75.8	125.1	124.4	102.5	1444.0

them. MPC benefits most during August of very dry years (90th percentile) when modeled hydropower production is about double of what it would be without Canyon Ferry Reservoir releases (see Table 3).

Figure 1. Comparison of modeled average total monthly power production for MPC Missouri dams under Scenarios 2 and 5.



To isolate the effects of irrigation, I made several model runs where I simulated the system as if Canyon Ferry Dam did not exist. The results of these analyses show hydropower production steadily decreasing as irrigation is increased from the 1928 to 1986 level. Modeled average MPC hydropower production, assuming a 1986 level of irrigation development and no Canyon Ferry Reservoir storage (Scenario 6: 1,883 GWhr), is about 1.5 % less than that under the 1928 level of irrigation development (Scenario 2: 1,911 GWhr). These reductions in modeled power production occur consistently during the entire irrigation season as shown in Figure 2.

I offer the following explanations as to why changes in hydropower production under the scenarios that do not include Canyon Ferry Reservoir are so small. The most important reason is that irrigated acreages in the basin have increased by a relatively small amount since 1928 (Figure 3). We've estimated that there were about 1,090,000 acres irrigated in 1928 as compared to about 1,244,000 in 1986, only about a 12% increase. There has also been a shift from flood to sprinkler irrigation in recent years, which has probably resulted in a small decrease in return flows, and associated hydropower benefits, following the irrigation season.

Figure 2. Comparison of modeled average total monthly power production for MPC Missouri dams under Scenarios 2 and 6.

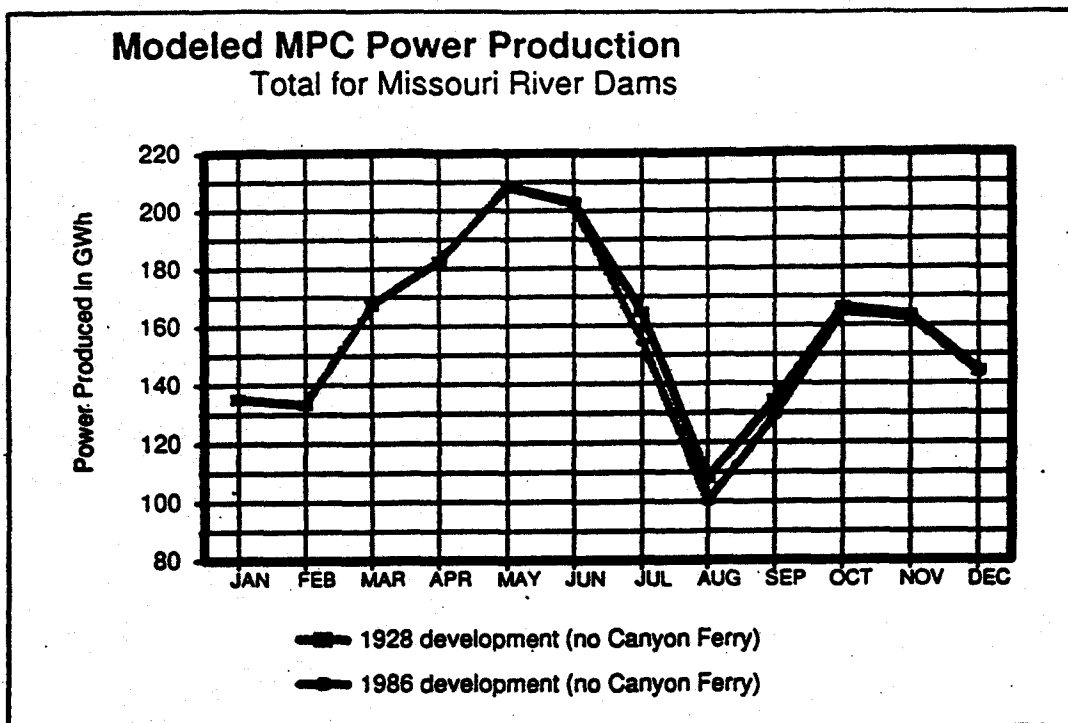
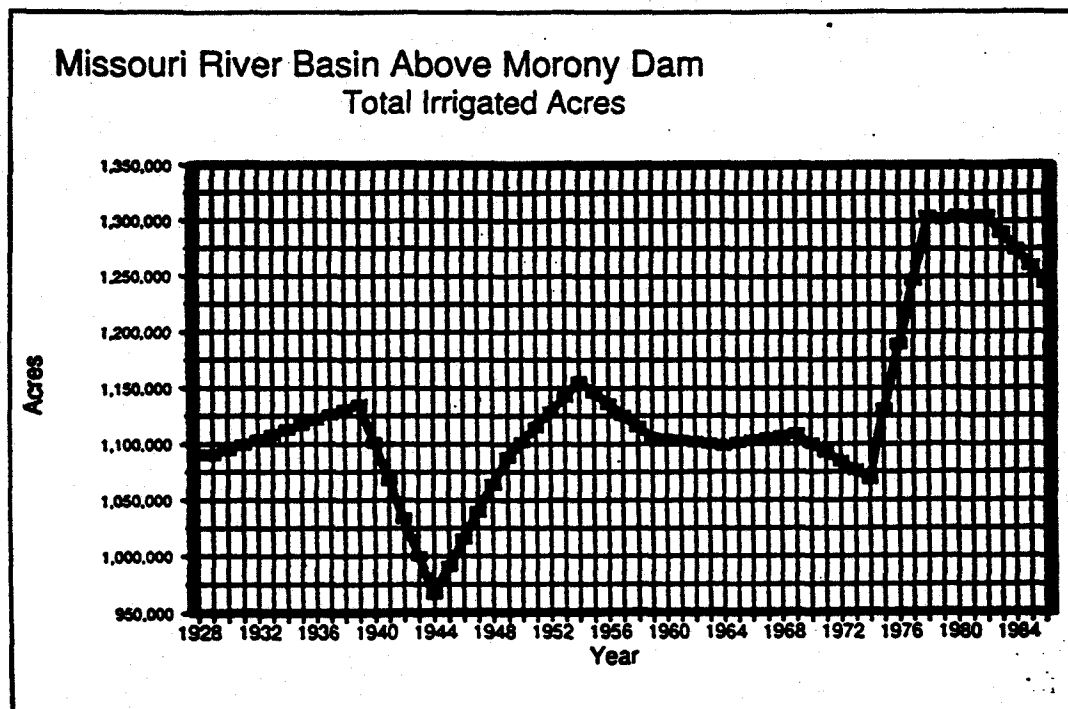


Figure 3. Total irrigated acres for the Missouri River basin above Morony Dam by year.



A final consideration regarding the Missouri basin is that MPC's claimed rights at several dams pre-date 1928, the earliest year I modeled (see Table 1). The largest earlier right is a 7,100 cfs claim for Holter Dam which has a 1918 priority date. I had Jim Kindle search the water rights data base and summarize irrigation claims that were made between 1918-1928. During this time, claims were made for about 103,000 acres of land (I excluded one 41,000 acre claim that was obviously in error). This represents only about 10% of the total acres modeled for 1928. Apparently, a great deal of the irrigated land in the upper Missouri basin was developed prior to 1918, and much of it probably decades earlier.

CLARK FORK BASIN

Introduction

Major hydropower claims and rights for MPC and WWP hydropower dams on the Clark Fork and Flathead rivers are summarized in Table 4. Trends in irrigated acreages in the Clark Fork basin for the period 1925 to 1980 are summarized in Figure 4.

One thing I noticed was that the irrigation data shows a large increase in acreage in the Clark Fork basin (Figure 4), as compared to the relatively small increase in the Missouri basin (Figure 1). An explanation for this apparent inconsistency is that reported irrigated acreages increases in the Upper Clark Fork and Bitterroot River portions of the Clark Fork basin since 1925 have been less than 10% since 1925--similar to that for the Missouri basin. The majority of the increases in irrigated acreage since 1925 have occurred in the Flathead basin and may be due in part to the development of large, federal irrigation projects.

Table 4. Major privately owned hydropower facilities on the Clark Fork and Flathead Rivers and associated water claims and permits.

Kerr	Flathead River	MPC	14,540	1938?
Milltown	Upper Clark Fork	MPC	2,000	1904
Thompson Falls	Lower Clark Fork	MPC	11,120	1913?
Noxon Rapids	Lower Clark Fork	Washington Water Power	35,000 claim 15,000 permit	1951 1976

For the Clark Fork basin, I've summarized information from the report "Effects of Future Irrigation Development on Hydroelectric Generation in the Clark Fork River Basin" which was prepared for DNRC by Montana State University in 1988 (MSU 1988). Besides investigating the

effects of future irrigation, this report contain modeled hydropower production at the four dams for natural conditions and for several levels of irrigation development between 1925 and 1980. MSU used the U.S. Bureau of Reclamations SIMULUP model of the Clark Fork system to model hydropower production, and assumed 1986-87 reservoir operations criteria. Some selected results from the MSU report are summarized in Table 5.

Figure 4. Total irrigated acres for the Clark Fork River basin by year.

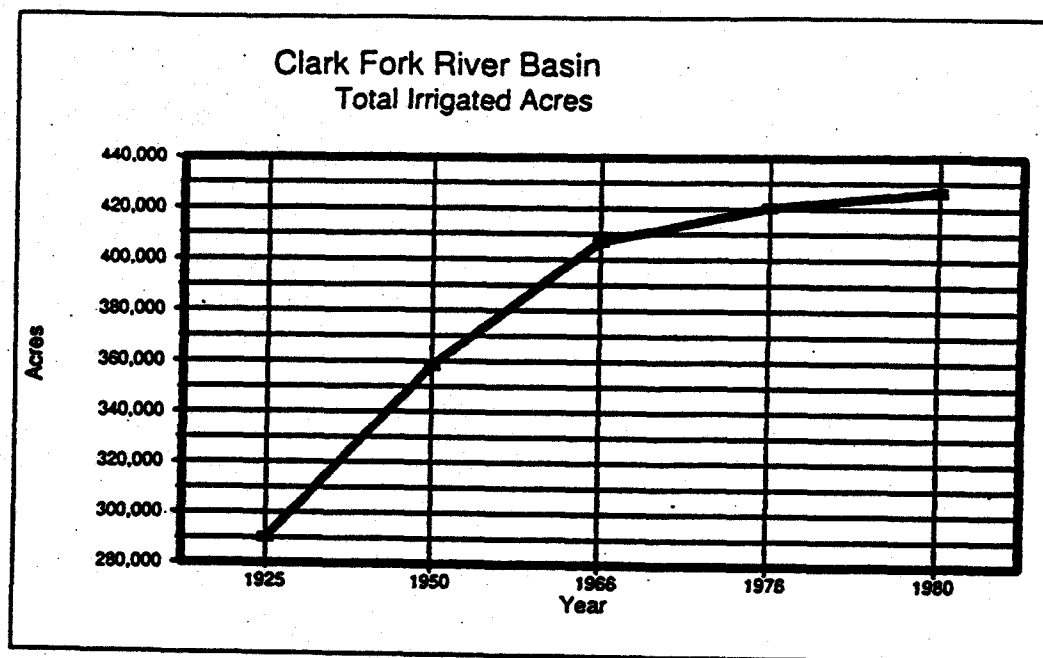


Table 5. Modeled average annual power production for hydropower dams on the Flathead and Clark Fork rivers.

Kerr	993.2	992.5	991.8	990.1	989.5
Milltown	21.5	21.5	21.5	21.5	21.4
Thompson Falls	329.6	331.0	331.0	330.7	330.3
Noxon Rapids	1921.4	1866	1853	1845	1841.1
Source: MSU 1988		LOD = Level of Development			

Discussion

Modeled average annual hydropower losses compared to natural conditions were only greater than 1 percent at Noxon Rapids (about 4.4%), but since the earliest claimed priority date for Noxon Rapids is 1951, it is more relevant to compare the 1980 and 1950 columns in Table 5. This comparison results in losses that are below 1 percent. These loss percentages are for average years; during drier years, the relative losses would be approximately twice as high.

For Milltown and Thompson Falls dams--both run-of-the-river facilities--average modeled hydropower losses were small. An explanation for these small losses would be that river flows at these dam usually don't drop below turbine capacities until late in the irrigation season. Some power production would be lost during this time, but the benefits to power production from irrigation return flows later during the fall and winter could offset some of these late-summer losses. An exception is for low runoffs years at Milltown Dam where data in the report (MSU 1988) indicate that annual hydropower losses of up to 10 percent were modeled.

At Kerr and Noxon Rapids dams, which spill much less frequently, modeled hydropower production consistently decreased as irrigation development was increased. The storage available at Kerr Dam and relatively large turbine capacity limit spills during the irrigation season. Noxon Rapids Dam was retrofitted in 1959 and, except during May and June of above average flow years, the entire flow of the river can generally be passed through the turbines. For these two dams, reductions in flow during the irrigation season generally result in losses to modeled power production and irrigation return flows were not sufficient to make up the losses.

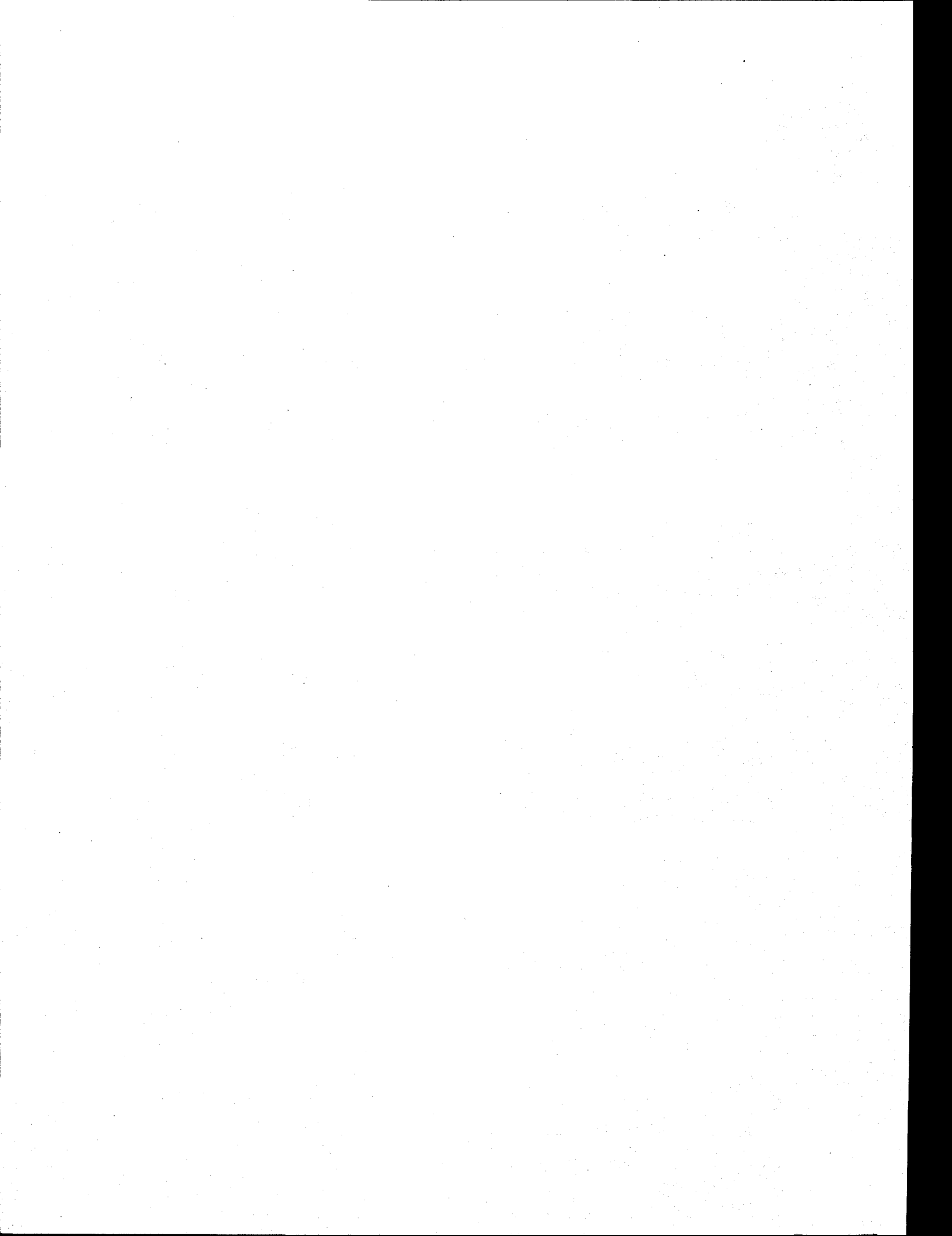
The U.S. Bureau of Reclamation investigated the potential for using Hungry Horse Reservoir storage to mitigate hydropower losses at the downstream dams (USBR, 1988). It found that there is some potential to mitigate these losses with reservoir releases, but pointed out several potential drawbacks including adverse impacts on Hungry Horse Reservoir levels.

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cc: Tim Hall Wayne Wetzel
 Mike McLane Anne Yates
 Jack Stults

APPENDIX 8



**Guidelines for Universal System Benefits Programs Funding
Credits and Expenditures
Draft #5 September 17, 1998 (2)**

Purpose of USBP Credit and Expenditure Guidelines

USBP credit and expenditure guidelines are designed to help utilities, cooperatives, large customers, the state USBP fund administrator, and the general public ensure that money generated through a universal system benefits nonbypassable charge produces public purpose benefits. The purpose of these guidelines is to:

- (1) Provide guidance for utility, cooperative, large customer, and state USBP fund administrator USBP expenditures that are consistent with 69-8-101 et.seq, MCA;
- (2) Provide consistency, predictability, flexibility, and discretion in directing USBP expenditures in a competitive environment; and
- (3) Ensure public accountability for USBP expenditures.

A balance of state fund USBP expenditures is essential both among and within USBP categories. Utilities, the state-wide cooperative pool, the state fund administrator, and large customers are encouraged to diversify and balance public purpose expenditures including qualifying low-income energy assistance expenditures. It is also recognized that because of the unique circumstances of large customer USBP expenditures, a balance of USBP expenditures among different USBP categories may not always be achieved. Utilities, the state-wide cooperative pool, and the state fund administrator are encouraged to expend state USBP funds in a manner that maximizes federal USBP matching funds.

These guidelines are not intended to be all inclusive. There may be activities that are not addressed within the guidelines that qualify for credits or expenditures. The guidelines have been developed to assist in the application of USBP-related terms and phrases contained in 69-8-101 et.seq., MCA. An omission in these guidelines, in no way implies or intends to affect credit amounts.

USBP Credit and Expenditure Guidelines Definitions

As used in these guidelines, unless the context explicitly requires otherwise, the following definitions apply:

Cost-Effective: means that the expected benefits accrued as a result of pursuing the action must exceed the expected costs associated with that action over some reasonable time period.

1 **Local Energy Conservation:** means energy efficiency projects implemented within the service
2 territory of a utility (anything within a utility's distribution area).

3
4 **Low-Income Customer Eligibility:** means those households whose annualized income is 150%
5 or less of federal poverty guidelines. Exceptions are subject to documentation on an individual
6 basis.

7
8 **Low-Income Customer Weatherization:** means a group of energy assistance measures targeted
9 at improving energy efficiency and energy-related safety of low-income homes.

10
11 **Low-income Energy Assistance:** means activities that better ensure affordable energy services
12 on a continuing basis to low-income households.

13
14 **Market Transformation:** means coordinated activities (at the state, regional, or national level)
15 that transform markets for efficient technologies and practices. The intent of market
16 transformation is to undertake activities that will increase the market share of targeted efficiency
17 products and services so that they will be sustained after incentives or other support is
18 withdrawn.

19
20 **Research and Development Programs:** means USBP programs related to a broad spectrum of
21 activities which are intended to identify, evaluate, develop, and/or demonstrate techniques or
22 technologies related to the acquisition of public purpose benefits.

23
24 **Renewable Resource Projects and Applications:** means projects and applications that use various
25 technologies to convert virtually inexhaustible energy sources to electricity or to perform useful work in
26 some way.

27
28 **Universal System Benefits Programs:** means public purpose programs for:
29 (1) cost-effective local energy conservation;
30 (2) low-income customer weatherization;
31 (3) renewable resource projects and applications, including those that capture unique social and
32 energy system benefits or provide transmission and distribution system benefits;
33 (4) research and development programs related to energy conservation and renewables;
34 (5) market transformation designed to encourage competitive markets for public purpose
35 programs; and
36 (6) low-income energy assistance.

37 38 **Credit and Expenditure Guidelines**

39
40 USBP credits may be applied to either the incremental cost or the total cost of a project, program,
41 or acquisition depending on the circumstances specific to that application. The entity filing for a
42 credit is responsible for developing appropriate documentation to justify its decisions relative to
43 each application.

In determining acceptable USBP credits or expenditures, the following guidelines apply:

1. ***Cost-Effective Local Energy Conservation:*** *Cost-effective local conservation credits and expenditures should include a cross-fuels analysis where appropriate. Pure load building costs or expenses are not acceptable USBP credit or expenditure activities.*

General list of acceptable credits or expenditures, including but not limited to:

- * Energy audits
- * Water heater programs
- * Grants or loans for lighting efficiency conversions
- * Grants for motor efficiency conversions
- * Expenses for consumer conservation education
- * Expenses for demand side management programs
- * Grants or low-interest loans for ground-source heat pumps used for energy efficiency savings
- * Irrigation audits to reduce power requirements
- * Programs such as Super Good Cents
- * Design/construction assistance for energy-efficient construction
- * Design/implementation assistance for retrofits of existing loads
- * Waste heat generation expenses
- * Street lighting -- security lighting upgrades for efficiency
- * Incremental cost of distribution efficiency expenditures attributable to increases in energy efficiency above acceptable minimum industry standards that are documented and verified by an electrical engineer.
- * Peak-shaving devices applied in customer facilities for the purpose of reducing peak demands excluding interruptible service or payment for curtailment rates.
- * Large customer conservation investments made pursuant to 69-8-101 et. seq.

2. ***Low-Income USBP Expenditures and Credits:*** *Low-income energy assistance and weatherization activities should be prioritized based on need and should be focused on broad-based activities that assure continuing affordable home energy services to qualifying low-income families. Customers must meet low-income customer eligibility requirements. Utilities and Cooperatives shall maintain documentation as necessary to justify their applications for low-income credits.*

General list of acceptable credits or expenditures, including but not limited to:

- * Outreach for LIEAP enrollment.
- * Funds contributed to endowments that qualify for low-income USBP purposes.
- * Safety/repairs related to low-income energy issues.
- * Energy-efficient equipment/technologies that help low-income households meet

- the cost of home energy.
- * Heating and energy crisis benefits including payments toward recipient households' energy costs.
- * Payment toward recipient household weatherization costs.
- * Purchase and delivery of fuels used by recipient households for home energy.
- * Purchase, delivery, and installation of weatherization materials.
- * Purchase and delivery of blankets, space heating devices, equipment and other tangible items that are provided to help low-income households meet the cost of home energy.
- * Discounted utility and bulk fuel prices for recipient households.
- * Partial or full waivers of utility and other income home energy connection and reconnection fees, application fees, and late payment charges.
- * Partial or full waivers of utility and other home energy connection and reconnection fees, application fees, and late payment charges.
- * Partial or full forgiveness of home energy bill arrearages.
- * Discounts or reductions in the costs of home heating and weatherization materials.
- * Services of paid staff donated by their employer to deliver fuel and other tangible items that help low-income households meet the costs of home energy.
- * Purchase, delivery, and installation of energy efficient equipment/technologies that help low-income households meet the cost of home energy.

3. ***Renewable Resource Projects and Applications: Any renewable resource funded by USBP money should be sited to minimize environmental impacts. In considering competing renewable resource projects and applications, preference should be given to solar, geothermal, and wind.***

General list of acceptable credits or expenditures, including but not limited to:

- * Photovoltaic conversion
- * Solar thermal applications
- * Geothermal projects
- * Wind power projects
- * Local micro hydro projects that are on streams outside protected areas as defined by the Northwest Power Planning Council or state or federal law, or that are irrigation ditch projects.

4. ***Research and Development: The cost associated with research and development activities in support of public purpose investments and programs are eligible for credits. In making research and development expenditures, the following issues should be***

considered:

- * technical feasibility,
- * economic feasibility, and
- * local applicability.

5. **Market Transformation:** Market transformation programs may overlap with renewables, local conservation, research and development and low-income expenditures and credits. In making market transformation expenditures the following issues should be considered:

- * Does the technology/process have a chance of becoming normal practice without the incentive?
- * Can or should the use of codes and standards be used to force changes in practice?
- * Will market transformation changes remain in place over time?

Guideline Enforceability

[The working group unanimously agreed that there should be public accountability for credits and expenditures. The ultimate decision on how to enforce the guidelines was left to the USBP Subcommittee.]

